# VALUERS' JOURNAL

MARCH
1994

## IN THIS ISSUE



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# NEW ZEALAND VALUERS'JOURNAL

## MARCH 1994 ISSUE




The NEW ZEALAND VALUERS' JOURNAL is the official publication of the New Zealand Institute of Valuers. The focus of the Journal is to publish researched articles on valuation, property investment and related matters, and to encourage the investigation and expansion of the frontiers of knowledge that cover such fields. It seeks to publish reports of decisions of hearings of tribunals, courts, and arbitrations of special relevance to the profession.

The New Zealand Institute of Valuers has a special interest in scholarly research that can be useful in property valuation and development, finance, investment, property management and market analysis, real estate and the valuation of plant. The Editorial Board is willing to work with any potential author who is developing new and exciting ideas. Articles and correspondence for the NEW ZEALAND VALUERS' JOURNAL should be submitted to the Editor at the following address:

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Complete editorial policy review process and style instructions are available from the editor. Business letters, subscriptions and advice of changed address should be sent to the General Secretary. The mode of citation of this volume of the NEW ZEALAND VALUERS' JOURNAL is (1994) N.Z.V.J. March page.

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# Feature Articles

# EDITORIAL COMMENT

## Adducing Methods of Valuation

- To capitalise maintainable net annual income or to discount net cash flow

Considerable debate has arisen recently in Australia regarding the validity of valuation methods for valuing commercial and industrial properties, particularly those in price brackets of millions of dollars. There seems to be an increasing lobby for the Discounted Cash Flow (DCF) approach on the grounds that the current downturn in the properties market in Australia has resulted in there being few sales of significant investment property and a consequent lack of market data on which to base valuations. Research Notes issued by the Australian Institute of Valuers and Land. Economists (AIVLE) in November 1993 stated that "much of the market data available has become distorted due to the impact of lease incentives or is simply not available because of confidentiality agreements." The Research Notes indicate Australian experience is that "Uncertainty as to capitalisation rates, market rental levels, letup periods and incentives have placed the capitalisation of net income as a method of valuation, under significant strain in recent times."

The AIVLE is however also conscious of an apparent lack of understanding by many practising valuers of DCF techniques and this deficiency in the knowledge or skills of many valuers has been confirmed by the conclusions in a research paper completed by R J K McIntosh which reviewed responses from a questionnaire circulated to a group of major investors in Australia.

It is suggested that if the same questionnaire was circulated in New Zealand similar results would be obtained, indicating a widespread lack of knowledge or understanding of DCF techniques amongst practising valuers and other professionals involved in commercial property.

The proponents of the DCF method of value assessment emphasise the advantages of these techniques as encompassing a facility to take into account, mathematically, expected future market conditions in respect of fluctuations in rentals, vacancies, demand and tenancy incentives. However, critics of the DCF method point to a major weakness in that the complexity of the techniques required to be undertaken to take account of all these factors renders the method difficult, if not impossible, for the application of valid comparative sales analysis. This shortcoming is further complicated by the fact that there is a definite lack of uniformity in the application of the techniques amongst practitioners and/or other users, that the results of analysis are rendered unreliable except perhaps to the exponent of the original analysis or the valuation assessment. The DCF method has the advantage of being transparent and displaying mathematically what is being calculated into a valuation assessment. But it is nevertheless unable to directly account for some other important market conditions such as the quality of tenants, location and age and condition of the structures. As a consequence, the DCF method, like the capitalisation of net income method, must rely on adjustment of the discount or capitalisation percentage rate to account for these additional market factors. The appropriate adjustments to the capitalisation rate are usually determined from simple sales analysis but there is apparently no accepted manner in which the discount rate should be adjusted for these additional market factors in the DCF techniques. Consequently the valuation assessments determined by capitalisation of net income have, so far as possible, market transactions as their basis, but the discount percentage rates used in DCF techniques have little or no regard to market evidence. A calculation of value using the DCF method must therefore be seen as an entirely subjective assessment.

The Courts in both Australia and in New Zealand have demonstrated a reluctance to accept valuation assessments based solely on discounted cash flow techniques. That is, until a recent decision in New Zealand, now known as the "McNulty Case" in which compensation was determined by the High Court of New Zealand at the Dunedin Registry between F.M. McNulty, McNulty's Transport Limited, Cromwell Ready Mix Supplies Ltd., B.F. McNulty and A.J. McNulty as claimants; and the Minister of Survey and Land Information as respondent. This judgement was given on 9 July 1993 and the case involved a claim for compensation for loss of land and gravel resource at Cromwell, Central Otago, where the claimant was involved in the gravel supply, transport and concrete industries.

The evidence revolved around the appropriate method of valuation of the land, the claimants two businesses and the appropriate discount percentage to be applied. The valuer for the claimant assessed compensation for the land taken and the consequent business loss on the basis of a discount percentage rate of 9.0% derived from Government Stock interest rate as at 1 June 1989 at 13.2% less the statistical rate of inflation at 4.04% giving a real interest rate of 9.16%. The valuer's evidence was that there existed only a very small range of business investment opportunities in Cromwell and consequently Government Stock was the most realistic alternative and safe investment available, and that 9.0% was the appropriate discount rate for a non-inflationary model. Incredibly, it seems to this writer, the valuer and another expert witness for the respondent agreed that the discount rate of 9.0% would be appropriate if the discounted cash flow method of valuation used by the claimant's valuer was correct, but apparently provided no evidence as to why it might not be appropriate. Both of these witnesses also qualified their acceptance of the 9.0% discount rate on the basis of the claimant's desire for the safest possible investment.

The decision of the Court was based on a discount percentage rate of 9.0% and the judgement clearly determined that the claimants were concerned to obtain the safest return on moneys available to them for compensation and that this provided the proper basis for a proper figure for a valuer to apply.

This writer ponders whether the Court was made fully aware that while the safest possible investment for the capital sum would be appropriate in a compensation claim, that capital sum would not allow for any business risk, which must have existed, as the lowest discount rate provides the highest net present value (capital sum).

It is suggested that while DCF techniques provide a valid basis for property investment comparisons, particularly "in-house" Internal Rate of Return (IRR) analysis, considerably more research needs to be carried out, and much wider understanding gained of all the factors that need to be considered in the selection of an appropriate discount rate. Although the traditional capitalisation of net annual income method of valuation requires, in some assessments, considerable assumptions to be made for appropriate adjustments to the capitalisation rate percentage, at least the basis for the rate percentage can be obtained from straight forward analysis of established real estate transactions.

Trevor J Croot

## New Zealand Institute of Valuers

# Annual Manuscript Competition

### CONDITIONS OF ENTRY

*The New Zealand Valuer's Journal* Editorial Board offers an annual Award for a leading article to be published in the Journal. The Award has a value of NZ$1,000 and shall be paid to the successful applicant who meets the following conditions:

1. The competition is open to any author of an original work based on research into or comment on a topic related to the valuation of real property.

2. Entries should be submitted to the Chief Executive Officer, New Zealand Institute of Valuers, P 0 Box 27-146, Wellington. The closing date for submission of manuscripts shall be 1st April in each year and any winning article shall be published in the Journal.

3. Preference will be given to "first time authors" and New Zealand Institute of Valuers' members. The author shall provide a brief biographical note which may be published.

4. The article shall not have been submitted to any other journal or published prior to being submitted for entry into the competition.

5. The article shall not exceed 10,000 words including any equivalent space where illustrations, diagrams. schedules or appendices are included.

6. The manuscript shall be typewritten, double spaced.

7. The author shall supply a short synopsis of the article, setting out the main thesis, findings or comments contained in the article.

8. The winning manuscript shall become the property of the New Zealand Institute of Valuers and the author shall agree as a condition of receiving the award to pass copyright to the Institute and no reprinting of the article shall take place without the express consent, in writing, of the Editor of the *New Zealand Valuer's Journal.*

9. All unsuccessful applicants for the Award shall be advised.

10. Judging shall be by the Editorial Board and shall be on the basis of the relevancy, quality, research and originality of the article to the principles and practice of valuation. The judges' decision shall be final and binding. The Editorial Board shall not be bound to make an award in any year if no article meets an acceptable standard. The judges reserve the right to nominate their own awardee should any article not be submitted for consideration by an author.

11. The decisions of the Editorial Board on any matter relating to the competition and Award shall be non-reviewable and correspondence shall not be entered into nor reasons given for the decisions of the Board.

# From The President's Pen

As this is the first issue of the Journal for 1994 it is appropriate for me to wish all members a successful, satisfying and prosperous year. 1994 will be somewhat of a watershed for the profession. By mid March the Institute will have received direct feedback from members by way of a postal ballot - on the discussions to join with two allied land professional organisations. If the vote has been positive then there will be a tremendous amount of time and effort required to bring the new organisation into existence. Alternatively, if our members vote not to form a new body with other property professionals, then the Council must activate strategies and plans to carry us forward into the next century as a dynamic, pro-active profession. As part of that planning a number of issues will need to be worked through.

These include:

- An update of the Valuers Act
- A widening of the valuation perspective beyond land and buildings
- Continuing professional development ongoing education and standards progression
- A recognition of professional skills in the wider land economy that are already within our ranks
- An analysis of our niche or "market" as a profession - does our name adequately describe who we are?
- Technology uptake and support for members
- Marketing of the profession public perception and comment

This list is not exhaustive and there will be other issues that assume increased importance in the year ahead. Whether we proceed into the future with a new broad-based land and property grouping, accompanied by management professionals, or as the Institute is currently structured, the points mentioned will remain relevant to any discussion on our direction and objectives as a profession.

# Book Review

## Legal Precedents For Rent Reviews

Reviewed by Gwendoline Jansen

"Legal Precedents for Rent Reviews" by Alan A Hyam, Barrister-at-Law, Australian Institute of Valuers and Land Economists, is available from Australian Institute of Valuers and Land Economists, 6 Campion Street, Deakin, ACT 2600. Price $A25.00 plus postage.

This new Australian book brings together the major legal decisions on rent reviews, with particular emphasis on case law relating to review procedures and interpretations of various commonly encountered lease clauses.

Firstly, the introduction sets out the history, purpose and operation of rent review clauses, by way of reference to several well known legal precedents.

Chapter two addresses the basis of assessments, through an examination of the construction of rent review clauses, and definitions of terms such as "the premises", "rental values" etc. Objective and subjective rent review tests are touched-upon, and legal precedents for considering rental evidence after a review date and whether or not vacant possession is to be assumed are also addressed, with case law quoted in each case.

Qualifying words ie "having regard to" and the treatment of regards and disregards are covered in some considerable detail, and also the matters to be taken into account when no directions to the valuers exist.

The next section covers the functions of the valuer, including the interpretation of market data in matters relevant to the rental assessment, appointment of the valuer, the validity of valuations (ie verbals), and the role of third valuer (ie umpire).

The book concludes by reviewing the main content; namely the explanations of many of the principles of rental assessments propounded by the Courts, including both those with general application and those relating specifically to the particular wording of a relevant clause.

In terms of usefulness to the New Zealand valuer, this book is considered most useful for the valuer who is closely involved with rent review determinations on a day to day basis, as well as the student learning about lease documents.

From a practical viewpoint, identifying sections within the book through the use of the index is not easy. Therefore it is recommended that if this book is to be used regularly, it should be read through when first obtained, so that users are likely to be able to recall which chapter deals with particular cases and items, rather than relying on the index. It is not a large book, and can be practically read and digested in a day.

Most of the ground covered is quite general, and the majority of case law will be familiar to New Zealand valuers regularly involved in rent reviews. Accordingly, it is considered more valuable as a background reference for the practitioner undertaking rent review assessments, rather than to answer specific queries which may arise during the course of a rental assessment or dispute.

For valuers specialising in rental arbitration work, the principle reference books available so far comprise Clarke & Adams' "Rent Reviews and Variable Rents" and the "Handbook of Rent Reviews" by Bernstein and Reynolds. Those books are expensive, however extremely detailed and valuable.

"Legal Precedents for Rent Reviews" is a more modest publication, being smaller and economically priced, and certainly does clearly set out the current legal precedents governing the procedures surrounding rent review assessments. This is essential knowledge for any involved valuer, particularly in the current economic climate where lease terms and conditions are being increasingly scrutinised by landlords and tenants and professional advice sought.

Note: This book is currently held in the NZIV Library.

# PEOPLEPROFILE

## Bill Burgess

A more progressive approach, and a wider sphere of activity are worthwhile changes within the NZIV, says Northland Council Member Bill Burgess. It is 10 years since Mr Burgess became a Council member and he says the NZIV has broadened its horizons considerably in that time. "Though we are still tied up to legislation, the Valuers Act was drawn up in 1948 and we would like to update it to 1994."

He is hopeful that this current session of Parliament will mean the Act can be modified, and give the NZIV more control over their own affairs. "We would like more lfexibility and control over our own destiny," he says. Perhaps a broadening of membership to bring in valuers from other fields such as fine art valuers, and other valuers would be one move. "There are a broad spectrum of people putting values on various property, they could be members too."

Born and raised in Gore, Mr Burgess became a rural field cadet and worked in North Canterbury and Gisborne before doing three years at Lincoln for his Diploma in Valuation and Farm Management. Bonded to the government for five years, he valued for 10 years in Whangarei and two years in Te Kuiti, with his last Government transfer back to Whangarei, as District Valuer. A short time later he went into private practice with Coutts, Milburn, the firm he now owns. "Mr Coutts retired shortly after and Mr Milburn went to Australia, so I purchased the practice and retained the name."

"I trained as a rural valuer and did that virtually exclusively in the Government, but I now do residential valuations as well."

He has seen a few changes over the years and suggests the most significant period for him was from 1972 to 1975 when virtually all property values doubled.

"Inflation was racing upwards, and even though I didn't think it could last, it still took about 12 years to steady." "The valuation profession has changed. From just being straight down the road and putting a value on property, it has branched out. Technology now, with a lot of computer assistance, makes it somewhat easier for us. There are more valuers coming on to the scene, especially with more Government redundancies, many of those people are going into private practice, and there is more competition."

Mr Burgess is married (for the second time) to Amy, and has three children, his daughter is a hairdresser in Hamilton, one son is an apprentice butcher and the other wants to be a carpenter. "None are going to be valuers, and I would have quite liked it if one had."

He belongs to Rotary, and is a life member of the Whangarei Old Boys Rugby Club (though he feels he is not old enough to be a life member), he played for them, was senior team captain for a couple of years, and President for two years. Golf and bowls take up a bit of his time and he plays some social cricket.

# EPROFILE

## Wade Briscoe

The valuation profession has been changed for the good with the advent of computers, says Wade Briscoe, Invercargill valuer, and NZIV Council Member for Southland. Mr Briscoe says the refinement of sales information now possible with computers, and the use of spreadsheets have all been good for the profession. He has some apprehension however, about a number of businesses providing "so called" valuation services. "Can `in-house' valuers always be impartial?" he asks.

Originally from Christchurch, Mr Briscoe went to Christchurch Boys High School before gaining a Rural Field Cadetship. He spent five years working in Gisborne, Oamaru, and Patuamahoe (near Auckland) before going to Massey University and Lincoln Agricultural College (as it was then) to finish off with a Diploma in Valuation and Farm Management. "I enjoyed those years," he says. "And it was to prove a very valuable background." Bonded to the Government for five years with the Lands and Survey Department, he worked at Blenheim and then Kaitaia on large-scale land development. He was then appointed Pastoral Lands officer based in Dunedin looking after high country runs. But after a year he applied for a job with J E Watson, Stock and Station Agents in Invercargill.

"I was Budgetary officer, but was also involved in valuations and got involved in some court cases on valuation matters," he recalls. He found valuation stimulating and set up on his own in 1973, and has been on his own since. These days he tends to specialise more in advising overseas clients, people looking at investing in niche properties or specialist activities. I like working with clients who give me pleasure, and it is always a challenge."

He also admits that even with the computer he seems to be working harder and longer these days. There is the need to improve and extend skills as well as maintain a competitive edge in a challenging environment. There can be difficulties as well as benefits for the smaller practice." He is a member of the Society of Farm Management, a Fellow of the NZIV having been a Council Member for 16 years. Mr Briscoe has served as board member and deputy Chairman of the YMCA in Invercargill, and was a synod member for a number of years for the Anglican Church. He was Chairman of the Takitimu Old Peoples Home. He lives with his wife Ruth, a registered nurse who works in the Out Patients department of Invercargill Hospital. They have three boys and one girl, all adults now and spread around New Zealand and the world.

He enjoys hunting and tramping, and has discovered the joys of *haute cuisine*. "It is a lot of fun, and I can do some fine things with venison, duck, paua, scallops, salmon or crayfish. There are a lot of benefits to living in the South Island."

# Environmental Liability And The Banker-Valuer Relationship

by Xan Harding

*Xan Harding is the manager of Payment Systems Policy for the ANZ Bank and PostBank at Wellington and was previously the manager of Credit Policy where he was responsible for developing lending policy.*

*Mr Harding was a runner-up in the inaugral 1993 Price Waterhouse Young Banker of the Year Award.*

*He holds a Batchelor of Horticultural Science degree with Honours from Massey University attained in 1987. He was admitted as a fellow of the Bankers Institute of New Zealand in 1993.*

## The Big Picture

Environmental liability is a New Zealand banker's worst nightmare, that may yet come true. As if banking was not already a hazardous enough business, battling to regain profitability after the ravages of deregulation and the severest economic downturn in 50 years, Parliament then saw fit in October 1991 to deliver banks a ticking time-bomb in the form of the Resource Management Act and potentially unlimited liability for their customers' environmental misdeeds.

Banks have existed and yes, at times prospered, on the notion that shareholders' funds and lending risks must be in balance. The balance is a delicate one and banks must devote an enormous amount of energy into preserving the balance in fact preserving the balance is the primary role of every bank lending manager. The Resource Management Act threatens to blow that delicate equation out of the water.

*"Parliament delivered banks a ticking time-bomb in the form of the Resource Management Act."*

Until October 1991, a bank could lend to industry and to property investors safe in the knowledge that at the very worst it could not lose more money than it had lent. Prudent banks controlled their lending exposures by industry sector and by company group, so that even in a major recession, shareholders' and depositors' funds would still be safe. Now, because of the Resource Management Act, a bank can lend a million dollars but risk losing 10 or even 100 times that amount.

Understandably then, banks are very concerned about environmental liability Parliament should be too. Like it or not, banks have a crucial part to play in the economy; converting cash and savings into working capital for industry and commerce. The `deep pockets' environmental liability approach of the Resource Management Act threatens the viability both of the banks and of the economic recovery.

*"Banks are very concerned about environmental liability."*

At a time when banks are facing almost unprecedented pressure to drop business interest rates and foster small business growth, they are in danger of being hamstrung by the threat of environmental liability. Paradoxically, smaller businesses represent in many cases substantially greater environmental risk to banks than do their larger counterparts. This is because a small business is much less likely to have sufficient capital to meet clean-up costs and is less likely to have a formal commitment to environmental best practice. It would be understandable then if banks became very cautious about lending to small businesses, when a $50,000 loan may result in the bank having to pay millions in clean-up costs. If such liability did not dry up bank finance lines completely, it would certainly dramatically increase business interest rates for everyone.

If common sense prevails, it is only a matter of time before Parliament heeds the advice of the banks, their Association and the associations representing other professional bodies that such deep-pocket environmental theory does not work and must be abandoned. There is ample evidence that the approach is fatally flawed - in America where the approach was spawned (by the courts, not by the legislature), it is estimated that more than 50% of the $US2000m spent on environmental liability every year goes on legal fees[1], achieving nothing for the environment.

The American legislature has sensibly reacted to the plight of lenders by passing a set of rules in April 1992 which protect their ability to manage loans and call up security without attracting environmental liability[2]. In New Zealand, the Ministry for the Environment has signalled its intention to consider the issue and has participated in the drafting of a joint Australia-New Zealand discussion paper published in June 1993[3], canvassing various liability alternatives and soliciting submissions.

However, even when the risk of open-ended environmental liability has passed, as it surely must, environmental risk will still be an important factor in a banker's credit assessment, because industry and commerce will increasingly stand or fall on their environmental performance.

So there will be an ongoing need for bankers to screen their borrowing customers for environmental risk - this is where the valuer comes in.

[1] Johnsen 1992 pp 237,240
[2] Farmer 1993, p 52
[3] ANZECC 1993

## Bank Liability for Environmental Contamination4

Before continuing, a brief explanation and a couple of examples of how a bank can assume liability for its customers' environmental misdeeds may be helpful.

Risk of environmental liability for banks is often described as falling into two categories - indirect and direct risk. Indirect risks are those which arise only through the effect of environmental matters on a customer's ability to repay its borrowings and therefore do not expose a bank to open-ended liability. Direct risks are those which can result in a bank becoming directly liable for damage to the environment caused by its customers, which may involve liability for sums vastly in excess of a bank's lending to those customers. Both types of risk arise primarily, but not exclusively, through the operation of the Resource Management Act 1991.

*"Liability under the Act can attach to anyone concerned in the management of a polluter."*

Under the Resource Management Act, a bank may be exposed to indirect risks in a variety of ways. Breach of a condition of a resource consent may expose a customer to heavy fines and even heavier clean-up costs, which may force a customer into liquidation. A local authority may step in to conduct a clean-up operation itself and register a charge on the land to recover its costs. A customers' competitors or an environmental pressure group may lobby for changes to a district plan aimed at putting that customer out of business. These are all examples of ways in which environmental matters may result in a bank being unable to obtain repayment of its loans, through a decline in a customer's debt servicing ability, decline in the value of security held, or a combination of both. Environmental problems can have a dramatic effect on business saleability and property values, so banks are likely to face a substantial loss of principal as well as interest when a problem arises.

Over and above these examples, a bank can become directly liable for environmental damage caused by its customers because the Resource Management Act attaches liability to any person who is an owner or occupier of affected land and in addition to anyone who is entitled to the rack rent of a property and to anyone who `permitted' contamination. Furthermore, liability under the Act can attach to anyone `concerned in the management' of a polluter.

A bank becomes the *occupier* of land when it enters into possession of the land when a customer defaults and it can also be argued that under standard bank mortgage documents, a bank becomes *entitled to the rack rent* of the mortgaged property as soon as a customer is in default of the terms of the mortgage, without the bank taking any action and even without knowledge of the default.

Particularly when a customer is struggling financially, a bank may become deeply involved in monitoring the performance of a business and in deliberations over its future direction - thus risking liability through *concern in the management* of the company or *permitting* pollution, even though a bank will almost never have decision making control over the business. In a US case *(Fleet Factors),* a bank was even found to be liable for environmental damage merely because it could have controlled the decision making which lead to the pollution if it so chose. For all these reasons, in some situations banks will consider walking away from their securities, rather than enforcing them and compounding their problems.

*"Valuers have a positive duty to factor environmental issues into their reports"*

Thus, with the general `greening' of the populace and the operation of the Resource Management Act, there are numerous ways in which a bank's customers will find that environmental matters will affect their financial viability and so it has become imperative that bankers assess the environmental risks faced by customers. As a customer's financial health deteriorates and the banker is forced to work closely with the customer to salvage the position, the risk that the bank may have to pay for environmental restoration costs itself rises dramatically.

## An Environmental Tool Kit

In broad terms, bankers have three distinctly separate but complementary tools at their disposal for environmental risk screening:

(i)normal credit assessment techniques - ie. common sense, general knowledge and an enquiring mind, backed up by technical lending knowledge and skills and an understanding of people;

(ii) registered valuers' reports - for determining the approximate value of the assets to be pledged to stand behind a loan in case debt servicing fails;

environmental audits - delivering expert opinions on the environmental state of business systems, management, assets, products and waste products.

Each of these tools has a place in environmental credit risk assessment - normal credit assessment techniques will always apply, and will include in each case an assessment of whether the latter two tools are required for the job.

## A Valuer's Role

Environmental considerations affect the market value of assets and so it is an inescapable fact that valuers have a positive duty to factor environmental issues into their reports, when the outcome is affected by them'. At first glance, this might strike some valuers as an intolerable burden, because of the relative newness and uncertainty of environmental issues. However, a valuer's valuation has never been and cannot be, an unequivocal statement of fact. It is merely the considered opinion of a highly trained independent professional, given in good faith. A valuer has nothing to fear but his or her own negligence, measured against the objective standard of the performance of his or her peers'.

Thus, provided a valuer is conversant with environmental considerations as they may affect the value of the asset being considered, exercises due diligence in arriving at an opinion on the asset's worth and remains at arms-length from the client, the valuer should be practically immune to claims of negligence' and therefore protected from environmental liability.

Of course, that is not to say that the valuer will always be right, nor unfortunately that those relying on a valuation will not from time to time seek to transfer environmental costs to valuers via the courts through negligence claims, irrespective of the merits of a claim.

'See also Walker, 1992 p 21 and McArley & Dickson, 1993, pp 29,30
'Dybvig, 1991, pp 29,31; Merrylees, 1991, p 568; Bornhotdt, 1992, p 23.
6Mahoney, 1990, p 14.
'Ibid, p 19

Contrast this though with the position of bank managers and shareholders - competence and due diligence may well stave off the long knife of accountability for the lending manager but if an environmental loss results because a customer cannot repay or because the bank is held to be directly liable, the shareholders will suffer regardless.

## Forging the Link

Banks will seek environmental solace from valuers in one of two ways - either by instructing a valuer directly, or by relying on a valuation prepared for mortgage purposes. If the former route is taken, the bank becomes the client and obtains the direct benefit of the valuer's unquestionable duty of care'. If the latter route is chosen, as is often the case through circumstance and convenience, the result is less certain.

The bank, seeking to rely on a valuation prepared for mortgage purposes but not directly for itself, will often as a precaution advise the valuer of the intended reliance. The bank may formalise this by asking the valuer to address a copy of the valuation to the bank and to confirm that the opinion still stands. Whether or not a duty of care is then created is a matter of debate.

The New Zealand Institute of Valuers (NZIV) Code of Ethics recognises that a valuer's duties extend beyond those to his client, whilst also recognising that the client comes first:

*Service*

*1. The first duty of every member is to render service to his clients or his employer with absolute fidelity, and to practice his profession with devotion to high ideals of integrity, honour and courtesy, loyalty to his country and the Institute, and in a spirit of fairness and goodwill to his fellow member, employees and subordinates.*

*Accuracy And Good Faith*

*16. Reliance placed by client, employers, shareholders, investors, creditors, and the public in general on the accuracy and good faith of statements prepared or certificates given by members constitute one of the most valuable assets of the profession and the utmost care and good faith are necessary to ensure the maintenance of the highest standards in this respect.*

The position at law is less certain the House of Lords in 1990 dealt a severe blow to a wider duty of care for professionals with its *Caparo* judgement, on public policy grounds'. However, their decision has been subject to some criticism in subsequent lower court judgements and has not always been followed"'. Commonwealth case law on the point involving valuers, whilst predating the *Caparo* decision, is more firmly of the view that valuers do have a duty of care to those who the valuer could reasonably foresee would rely on the valuation". The facts of the *Caparo* case may also distinguish it from the situation of a valuer preparing a valuation for mortgage purposes, regardless of whether that case continues to be followed.

In the face of this uncertainty and with memories of a few `over-optimistic' valuers still fresh in bankers' minds, the incidence of banks instructing valuers directly is increasing. However, to the prudent valuer exercising due diligence and fulfilling the expectation that they will act with integrity, total independence and objectivity's in preparing a valuation for mortgage purposes, the question of whether the purchaser or the bank is the client should be immaterial. The prudent valuer would also recognise the widespread acceptance within the profession that a duty of care to third parties in such a situation does exist".

For bankers, the decision on whether to retain the valuer should be based on the need to ensure sufficient experience, expertise and integrity is applied to the particular type of property at issue, rather than on ability to sue for negligence.

## Beyond the Link - Bankers' Motives Unmasked?

Of vital interest to the valuer will be the bank's intended use of the completed valuation. A valuation with a clean environmental bill of health is not a substitute for the exercise of common sense and due enquiry on the part of lenders14. Bankers cannot shut their eyes to the obvious and then hope to rely on a valuer's professional indemnity insurance. Thus the proper role of a valuer in the eyes of a banker can only be to bridge the gap between a prudent and competent banker's knowledge and the territory which screams "Environmental Risk!" and demands an environmental audit.

To put it another way, the practical use of valuers' reports to a banker, for screening environmental risk, is limited to those situations where a prudent and competent banker has no evidence and no reason to believe that an asset is environmentally tainted.

The onus is therefore on both valuers and bankers, within the limits of their respective professions, to understand the ways in which environmental problems manifest themselves and to take precautions accordingly. For bankers, this means understanding their customer and being able to recognise an at-risk business. For valuers, this means getting to grips with environmental legislation and the way in which it is administered". Valuers must realise though, that where they are experts, bankers are only laymen and bankers look to valuers for specialist property advice", environmental issues included.

## Qualified Valuers and Qualified Reports

In the face of uncertainty, some valuers may be tempted to rest largely on their prior training and their current knowledge and merely submit their reports with a general qualification as to environmental issues which may affect the value of the asset being considered. This is not the answer - qualifications are not a substitute for due care and skill and will not generally override a valuer's fundamental duties".

However, that is not to say that there is no place at all for a report qualification as regards environmental issues. A well drafted qualification will draw the reader's attention to the limits of the valuer's enquiries and expertise in matters environmental but it should not exonerate the valuer from the obligation to be informed on such matters and to apply his or her eyes, ears, knowledge and skills to the problem.

"Jefferies, 1990, p 21.

91n Caparo, auditors were found not to be liable to shareholders for negligently preparing the accounts of a publicly listed company - the potentially huge scope of liability for a professional to a multitude of parties appeared to influence the final decision.

'oBaxt, 1993, p 217.

"Mahoney, 1990, p 17; Nathans, 1993, p 363; Mahoney, 1 991, p 36

2See Speedy, 1991, p 39 and Mahoney, 1991, p 38.

"Sowry 1989, p 22; Jefferies 1990, p 21; Dybvig, 1991, p 25; Mahoney 1990, p 19

"See *Kendall Wilson Securities Ltd v CT Barraclough and Barraclough Bros Ltd* (1986) 1 NZLR 576

5Speedy, 1 992, p 26.

6Teoh & Croft, 1992, p 29.

"Mahoney 1990, p 19; Dybvig, 1991, p 31.

Any report should clearly demonstrate fulfilment of the valuer's duty of care'x Most environmental problems are visible or can be deduced with common sense from an understanding of a property's history'9. Valuers should refuse to act if they do not have the knowledge or experience to value a property outside their area of expertise20.

Bankers will need to exercise vigilance and, as a last resort, judicious use of their market power, to ensure that valuers do address environmental matters. However, they must also understand that appropriately drafted qualifications can have a place in registered valuers' reports and indeed may be essential if the valuer is to obtain Professional Indemnity insurance21. Valuers should remember that any limitations to the scope of their role can, as a matter of contract, only be imposed at the time of engagement".

## Scope of A Valuer's Duty - What the Valuation Standards Say

Valuation standards continue to develop. NZIV Practice Valuation Standard 1 (Residential Properties) and Provisional Practice Standard 2 (Rural Properties) are very clear on the matter:

*The Valuer's Role*

*"...to advise the client as to ... any factors likely to materially affect its value."*

*The Valuer's Report*

*"A clear statement of all matters relevant under the Resource Management Act 1991."*

*The Valuation*

*"All matters relevant under the Resource Management Act 1991."*

NZIV's Exposure Draft for Suburban Commercial Property retains the same description of the valuer's role but is a little more vague on the point in other areas:

*The Valuer's Report*

*"A clear statement of the existence and implication of the zoning or any other resource management notation relating to the property including highest and best use scenarios."*

*"If it is suspected that hidden defects exist which could have a material effect on the value of the property, the valuer should so advise and recommend more extensive investigation and either defer providing a valuation until the outcome is known or provide a valuation recording the assumptions made in this respect."*

The International Asset Valuation Standards Committee Information Paper No. 11 (entitled `Effect of Environmental Factors and Pollution') is rather more instructive on the issue but as yet has not been adopted by the NZIV. It states:

*"a valuer's duty to consider environmental issues goes beyond the `qualify and pray' approach"*

*2. Where a problem is identified by normal diligence, it is the Valuer's responsibility to provide a valuation in which the nature, extent and result of inquiry must be disclosed, whether based on the Valuer's research or an external environmental audit. There is also a positive responsibility on the Valuer to recommend that a detailed environmental audit be carried out where initial research identifies a problem or a potential problem.*

*3. In many cases, it will not be within the Valuer's competence to calculate the costs and means of dealing with specialist areas of environmental pollution. In those cases where such potential problems can be identified, the Valuer should recommend an environmental audit* as a *precursor to the valuation report.*

*Recommended Approach*

*The following recommendations are proposed in the case of any suspicion, indication or sign of pollution.*

*2.3 Where any such pollution is not within the experience and competence of the Valuer, the client should be advised to obtain technical advice. The completion of the valuation would then require association with or the retention of others who possess the required knowledge and experience.*

Thus it has been recognised internationally that a valuer's duty to consider environmental issues goes beyond the `qualify and pray' approach, to a positive duty to recommend an environmental audit where a problem or potential problem exists.

One Australian lawyer summed up the situation perfectly when he wrote:

*.. when determining an issue of negligence in a valuation, the court will have regard to the standards and practices adopted by the leading and most knowledgeable members of the profession in determining what is reasonable."23*

In its deliberations, a New Zealand court will not necessarily restrict itself to examining local professional practices to establish a performance benchmark - particularly in areas of law such as environmental liability, where there is little local precedent. Thus valuers should be aware that international environmental best practice dictates that not only should they consider environmental issues in their reports but also that they should refuse to complete a report without professional environmental advice if there is any sign of an environmental problem.

## The Banker-Valuer Relationship in Perspective

As every seasoned banker knows, security is something you can hold in your hand. Anything else is cold comfort - nobody wins when litigation is the only solution. A banker's main defences against environmental liability are his or her common sense, lending skills and knowing when to call in the experts. A registered valuer's report is only a tool to reduce the number of nasty surprises which make it through those main defences.

Banks must look first and foremost to their own practices to control environmental risk. Valuers must equip themselves with the skills to function properly in the new age of environmental accountability.

In the absence of negligence, environmental liability must fairly fall on those who are responsible, not on those who merely advise or lend.

*The assistance of the New Zealand Institute of Valuers in researching this article is gratefully acknowledged. The opinions expressed in thi article are those of the author and do not necessarily represent those v f ANZ Banking Group (New Zealand) Limited, or the New Zealand Institute of Valuers.*

'Mahoney 1990, p 19.
'Hunt, 1993, p 360; Man, 1991, p 503.
20Jefferies, 1990, p 22.
"Mahoney 1990, p 19.
22 Sowry, 1989, p 22.
23Nathans, 1993, p 363.

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NEW ZEALAND INSTITUTE OF VALUERS

# YOUNG PROFESSIONAL VALUER OF THE YEAR AWARD

The "New Zealand Institute of Valuers Young Professional Valuer of the Year Award" has been implemented with effect from 1 January 1993 with nominations called for by December 1994 for conferring of the Award in 1995.

## ELIGIBILITY CRITERIA

1.Members or Affiliates of the Institute aged 30 years or less shall be eligible.

2.The criteria for the Award is:

a) Significant professional participation within the NZIV, or b)

Original research of outstanding significance; or

c) Original authorship of outstanding significance;

and

d) i) outstanding technical and or professional excellence; or

ii) significant contribution to the community that brings credit to the Profession.

The research or authorship shall be available to the Editor of the NZVJ for publication at the Board's discretion.

3. There will be only one national award each year, and this shall only be conferred if the candidate is worthy of the award and shall not be automatic.

4. The award shall comprise the presentation of an appropriate "certificate" and the full expenses for the awardee to attend the NZIV AGM and National Seminar, at which the Award will be presented.

5. Initial selection shall be at local Branch level with final selection being by a national award panel comprising Chairmen of the Institute's Promotions Committee, Education Board, Editorial Board and President.

6. Nominations may come from any sector within the profession or outside (eg Branch Committees, Councillors, employers, community service groups etc) but may not be by application from prospective awardees.

Nominations to be forwarded to NZIV's Chief Executive Officer by 30 November each year at P 0 Box 27-146 Wellington New Zealand endorsed "Application for Young Professional Valuer of the Year Award".

Advice of the availability of the Award will be published in the NZVJ and Valuers NewsLine, by way of advice to all members, in the first issue of the Journal and NewsLine each year. Members are encouraged to advise their employers of the award, and to assist employers with nominations the NZIV has prepared an information kit to aid them in making nominations for the award.

John Gibson

CHIEF EXECUTIVE OFFICER

# Business Valuations of Rest Homes and Hospitals

by D J O Archbold

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There are many types of Continuing Care Institutions that provide long-term care for geriatric clients. This paper concentrates on just two types - the rest home and hospital facilities which exist in both the public and the private sectors.

When looking at the industry and the changes that are taking place in the Health sector, we are looking at the industry as a whole - both public and private. In the context of valuations we are concerned with the private sector at the moment. Given that one of the thrusts of the Health reforms is the application of business principles to the Public Health sector, I see no reason why public sector Hospitals and Rest Homes cannot be valued in the future on the same basis as the private sector is now. The Health sector reform papers refer to "contestability" and a "level playing field" very frequently.

There are a number of differences however between rest homes and hospitals which provide geriatric care, and these are discussed later.

The number of Continuing Care beds can be summarised by Regional Health Authority (RHA) districts, as follows

REST HOME BEDS

| R.H.A. District | Population 65+ | Private Beds | Public Beds | Total Beds | Rate/1000 65+ |
|---|---|---|---|---|---|
| Northern | 120,330 | 6,655 | 97 | 6,752 | 56 |
| Midland | 76,830 | 4,255 | 60 | 4315 | 56 |
| Central | 98,440 | 4,571 | 65 | 4,636 | 47 |
| Southern | 96,330 | 5,481 | 78 | 5559 | 57 |
| Total | 391,930 | 20,962 | 300 | 21,262 | 54 |

HOSPITAL BEDS

| R.H.A. District | Population 65+ | Private Beds | Public Beds | Total Beds | Rate/1000 65+ |
|---|---|---|---|---|---|
| Northern | 120,330 | 2,388 | 257 | 2,645 | 22 |
| Midland | 76,830 | 905 | 383 | 1,288 | 17 |
| Central | 98,440 | 1,059 | 721 | 1,780 | 18 |
| Southern | 96,330 | 1,394 | 874 | 2,208 | 23 |
| Total | 391,930 | 5,746 | 2,175 | 7,921 | 20 |

The assessment of clients as to their suitability for various forms of care is a very vexed question. Future assessments of clients are to be done in the Assessment and Rehabilitation Units of CHE's. These are to be done in terms of the Support Needs Assessment Protocol (SNAP). An appropriate definition of a Stage IV client who should be admitted to a long stay hospital is:

*"A person who has a condition which may be medical, physical, psychiatric, intellectual or age related, which requires 24 hour nursing management by Registered GenerallComprehensive or Psychiatric Nurses".*

The ratio of State subsidised clients to non-subsidised clients in rest homes is approximately 45% subsidised/55% non-subsidised. The proportion of subsidised clients could increase as a result of deposit interest rates continuing to fall.

The assessment of subsidy requirements has been in terms of an income-assessed test for rest home subsidies and an asset based test for hospital subsidies. These regimes were amalgamated from 1 July into a new targeting regime for older people. Rest home and hospital subsidies are available to an asset threshold of $6,500 for a single person, $13,000 for a married couple both in care, and $20,000 for a married couple with one partner at home. Subsidy levels available to clients are assessed by New Zealand Income Support Services.

The Department of Social Welfare Rest Home subsidy levels up until 1 July 1993 have been -

| | Maximum Subsidy Per Day excl. GST |
|---|---|
| Category 1 | $55.14 |
| Category 2 | $64.00 |
| Category 3 | $82.43 |

Rest home occupancy levels vary throughout the country with the range being from 77% in the Northern RHA district to 98%

This paper was presented at the valuation seminar held at Massey University, Palmerston North, on 16-17 August 1993.

in the Central RHA district. These occupancy rates are as at December 1992. There is some recent evidence which indicates that Rest Home occupancy has declined by up to 5% since then.

Users of long stay care at 31 March last were

| | |
|---|---|
| Private Rest Home clients who pay full fees | 8,100 |
| Private Rest Home clients who receive a subsidy | 8,500 |
| Public Rest Home clients | 300 |
| Private geriatric hospital clients | 4,500 |
| Public geriatric hospital clients | 1,800 |

Over the past ten years there has been considerable growth in rest home bed numbers as well as substantial improvements to existing rest homes. Expansion of bed numbers has been both in the form of additions to existing rest homes, the building of new stand-alone rest homes, and the building of new rest home wings in conjunction with hospitals and retirement villages. The physical condition of many rest homes ten years ago was quite indifferent. The standard of services available in rest homes today is overall very satisfactory. There have been no limits as to rest home bed numbers. The rest home subsidy is a client based subsidy, thus it has been a matter of judgement by developers and those wishing to provide additional beds as to the availability of clients either private paying or subsidised. Up until recently, astute developers have been successful in developing good quality rest homes which have filled relatively quickly.

Rest Homes are graded as follows:

Stage I

Licensed old people's homes which provide care for residents who are assessed using the dependency scale and are category 1 (some) dependency, or category 2 (moderate) dependency. Homes have to meet minimum licensing requirements.

Stage II

Licensed old people's homes which have been assessed by Ministry of Health Licensing staff as meeting the prerequisites of Stage 11 Rest Homes. The prerequisites for a home wishing to be graded as a Stage 11 home were developed on the basis that no more than 30% of residents in the rest home were category 3. Homes have to meet minimum licensing requirements, additional prerequisites concerning staffing, and have additional facilities relevant to the dependency of residents.Approximately 85% of rest homes are Stage 11 homes.

Stage III

Stage III rest homes provide services exclusively for residents who have been diagnosed as having Alzheimers disease or age related dementia. Separate units within existing rest homes may be graded Stage III provided they meet certain prerequisites. Homes have to meet minimum requirements and specific prerequisites tailored to people with dementia.

The growth in private hospital geriatric beds over the past ten years has been considerably less than that of rest homes. This is because 80% 85% geriatric patients have been subsidised in terms of the Geriatric Hospitals Special Assistance Scheme (GHSAS). This has been a client based subsidy which has been administered by Area Health Boards. This subsidy was available to a client when a suitable public bed was not available. Because of the high ratio of subsidised clients, those wishing to provide additional private hospital beds effectively needed to obtain the approval of the local Area Health board before they could proceed.

There was additional growth in private hospital beds some years ago when Area Health Boards became aware that because of financial allocations, that geriatric clients could be transferred to the private sector in terms of the GHSAS Scheme, and public sector funding remained unchanged.

Private hospital occupancy levels have ranged from 60% in the East Coast region to 92% in Taranaki, with an average occupancy of about 70%. These occupancy rates are at December 1992. There is some evidence that Private Hospital occupancy rates have decreased by 5% since then.

Private Hospital fee levels vary considerably between regions. Fee ranges prior to 1 July by RHA districts can be summarised as follows -

| RHA District | Daily Fee (excl. GST) |
|---|---|
| Northern | $105 to $145 |
| Midland | $95 to $130 |
| Central | $95 to $125 |
| Southern | $90 to $115 |

Thus, over the past 10 years we have seen the build-up of a private sector based, institutional orientated industry which is substantially subsidised by the State in various forms. It is also fair to say that the level of State funding as a proportion of total funding has also increased over the past 10 years.

The characteristics of the present industry can be summarised as follows

I . A high proportion of State involvement and funding.

State involvement in the industry is both in the form of public continuing care beds (Rest Home and Hospital), and various client based subsidies in the private sector.

2. A mix of "for profit" and "not for profit" in the private sector.

The "for profit" portion of the sector consists mostly of small single unit ownerships. However, there are a number of larger private companies and organisations who have a number of rest homes and private hospitals in both the North and South Islands and who each control over 200 beds.

The "not for profit" portion of the industry consists of a wide range of Religious and Welfare organisations. Again these vary considerably in size and in the services they provide. They have been characterised in the past-by lower fee structures which have come about because of volunteer labour, lesser input costs, and a beneficial tax regime.

3. Wide variations in bed densities.

The Ministry of Health has a guideline for rest home beds of 30/1000 population over age 65. The Ministry of Health guideline for hospital (both public and private) geriatric beds is 18/1000 over age 65.

At RHA level, the density of rest home beds ranges from 47/1000 for Central, to 57/1000 for Southern. Within RHA's, there are wide variations. Using Midland RHA as an example, we see a range of rest home densities from the Otorohanga District at 23/1000 to the Rotorua District of 94/1000.

In terms of geriatric hospital beds (both private and public), Northern RHA has 22/1000, Midland RHA 17/1000, Central RHA 18/1000 and Southern RHA 23/1000. But again, using Midland as an example, we see a wide variation with the South Waikato District having no beds and thus 18/1000, through to the Waipa District at 37/ 1000.

The above factors mean that the changes that are taking place in the public Health sector at the present time will have a major effect on rest homes and private hospitals in the future.

RHA's are making it plain that they will purchase services from providers to the extent that they perceive they need to do so. They are also seeking to achieve the widest possible range of services for their clients. It would appear that the Hospital guideline at 18/1000 is looked upon as a more reliable guideline for purchasing services, than the Rest Home guideline of 30/1000.

The present system is seen as being inflexible. The only way an elderly person could receive State assistance in the past was for them to pick up a subsidy and go into a rest home or hospital. The aim of RHA's in respect of the care of the elderly is to provide a choice for the client and including choosing to stay in their own home.

The planning of the Health changes has been done, they are starting to be implemented now, and their effects will be felt in the industry over the next few years.

What does all this mean for the future of rest homes and hospitals providing geriatric care given that -

1. Rest home bed numbers overall are in excess of Ministry of Health guidelines.
2. Continuing care hospital beds numbers are close to Ministry of Health guidelines.
3. There are wide variations in bed densities as between districts.
4. Available client numbers will decline as a result of the availability of subsidies for Community Care. It is expected that a wide range of home based care and services will be available in the near future.

From 1 July the funding of all subsidies for the care of elderly has been the responsibility of the four RHA'S. Three of the RHA's have simply rolled over the existing rest home and hospital funding arrangements for various periods of up to six months. The Northern RHA (North Health) rolled over rest home funding arrangements, but negotiated Contracts with hospitals from 1 July.

Providers in the Auckland and Otago Area Health Board districts had Contracts for 1992/93. Other districts will have two forms of Contract. An initial Contract will provide for the grandparenting of clients at 1 July for up to three years at agreed Contract rates. Obviously, all providers who have subsidised clients will have this Contract. The second Contract will be with "preferred providers". Clients and their families receiving a subsidy will be able to choose which "preferred provider" to use.

Quite clearly, given the factors outlined above, some existing rest homes and hospitals (both public and private) will not be "preferred providers". I anticipate that some providers (both private and public) will have lower occupancies and may face financial difficulties as a result of not being able to negotiate a Contract with their RHA.

The Contract negotiations that are taking place at the present time with providers substantially concern Price, Quality and Location. These negotiations are for Contracts for one year. Future Contracts will probably be for three years.

The RHA's are looking for occupancy discounts. This would indicate their preference to negotiate Contracts with a lesser number of providers. They are also indicating a preference for existing and established providers. I anticipate that there will be lower numbers of subsidised clients available for institutional care. In localities with high bed densities this will manifest itself in the form of lower bed occupancies. The proportion of subsidised and non-subsidised clients will become highly significant.

In terms of future occupancy levels, it is likely that hospitals will be less affected than rest homes. This is because of the likely impact of community care on what were clients who would have moved into a rest home. Community care is not a viable alternative for hospital clients who require 24 hour nursing care. A side effect of changing client patterns and lower occupancy levels will gradually result in the upgrading of rest homes to hospital standards, and could result in the merging of the roles of both types of institutions into a new type of institution similar to the Australian "Nursing Home".

Quite clearly then, the negotiating of a Contract with the local RHA is a necessary prerequisite for all rest homes and hospitals who have subsidised clients. If a facility does not have a Contract, then questions need to be asked as to what needs to be done to obtain one. The requirements of the RHA may be many and varied. Real problems lie in those localities which simply have too many beds. Many of these localities have experienced competition between facilities for some years. As a result, most of the rest homes and hospitals in these localities have upgraded buildings, have good quality management, and give very good client care.

I anticipate that despite having a Contract from the local RHA, that there will be rest homes and hospitals in these localities that will experience lower occupancy levels. Some may have financial difficulties in the future simply because there will be insufficient clients. Also, in the case of leased facilities, I anticipate some rentals may not be sustainable, and that some lessees may have difficulties. This could also flow onto the more highly geared lessors.

How does all this relate to a valuer valuing an individual rest home or hospital? In my view, a Valuer, valuing a rest home or hospital must be familiar with what is happening in the industry and what is happening in the locality in which he or she is working. He or she must also make a commitment in keeping up to date with the changes that are taking place.

In the past, the continuing care industry has been very stable, it has experienced good growth, and the financial rewards have been satisfactory. In the case of some developers, very good returns have been achieved. This has resulted in financial institutions looking at rest homes and hospitals as being good risks. In most instances there has been little difficulty in raising finance.

Clearly, the industry is going into a period of change. The change could take two to three years. I believe that this period of change will result in some rationalisations. All existing providers may not survive this period of rationalisation. However, to have the best possible chance to survive, rest homes and hospitals need to have good quality buildings and improvements, together with effective management. They will need to have achieved the required quality standards within the next year. These include the various Quality Assurance and Accreditation programmes. Comment in respect of the progress made in reaching the required quality standards needs be made in a Valuation report.

There are definite opportunities which arise as a result of the reforms for rest homes and hospitals. The most immediately obvious of these is Community Care. I am aware of a number of rest homes and hospitals that have put Community Care proposals to their RHA. Community Care, Day Care, Meals on Wheels etc, are obvious extensions to institutional care. Many providers are looking at involving on-site Occupational Therapists, Physiotherapists, Podiatrists, and medical personnel in Community Care programmes.

The population of New Zealand is ageing. Statistics New Zealand Medium Population Projections projects for the period 1991-1996 a 15.6% increase in the population over age 65. Unfortunately, the incidence of Alzheimers disease is increasing in the population, and it is likely that it is this rather than a general ageing of the population that will result in an increased demand for Continuing Care institutions.

When looking at the physical features of a rest home or hospital, the Valuer needs to check that the relevant Licence is current. The most recent licensing report should also be sighted. Any deficiencies noted in the inspector's report should be noted. Desirably, the report should be an Appendix to the Valuer's report. Ministry of Health Regional Licensing Offices are located in Auckland, Hamilton, Wellington, Christchurch and Dunedin.

Other important areas of concern in respect of physical features include fire protection systems and the requirements of the Building Act. In respect of fire protection systems, comment needs to be made in respect of existing systems. If a sprinkler system is not installed, then comment needs to be made in respect of when a system will be operational. Comment also needs to be made as to whether both the alarm and the sprinkler systems are connected (separately) to the N.Z. Fire Service.

Rest homes and hospitals have specific requirements for adequate and reasonable access and facilities for people with disabilities. They also have requirements in terms of the Disabled Persons Community Welfare Act. The relationship between these two Acts is discussed in an article in the Building Industry Authority News of June 1993.

When looking at the value or price of rest homes and hospitals both as a valuer and as an investor, I have preferred to look at their value in terms of "the present value of future achievable benefits", rather than measuring the past profitability. Certainly, the past trading accounts are of interest and must be analysed. However, I prefer to look at the future. This is why I consider that estimates of income and expenditure are critical to the valuation process.

I have examined various methods of valuing these properties as Going Concerns over recent years. I have concluded that the two most reliable methods are the comparison with sales of other properties, and also the capitalisation of Income Approach. The other method which has been used in the past is combining the Summation Approach together with an assessed value of chattels and also an assessed value of goodwill, to arrive at a total Going Concern value. I am of the view that this approach is of little real assistance.

If sufficient sales are available and properly analysed, then this data is most reliable. All circumstances relating to the particular sale need to be known as do the characteristics of the property, the past occupancy, and the Contracts associated with the property. Given variable occupancies as between properties, I analyse sales both on a licensed bed basis, and on an occupied/unoccupied bed basis.

The volume of sales of rest homes and hospitals has slowed down of late, with the result there is little private hospital sales data available at the present time. A number have been for sale. The ones that have been for sale in many cases have been those with low occupancies. Some have also been for sale in areas where there are high bed densities. The most recent sales of rest homes have been in the $30,000/bed to $35,000/bed range. As a result of the changes that are taking place in the Health sector, and thus the level of uncertainty surrounding the industry, it is likely that there will be fewer sales available for analysis in the short term.

The capitalisation of net income or Future Attainable Profit method, when correctly applied is in my view the most appropriate other method of assessing the value of the Going Concern. The factors to be taken into account in assessing the future attainable Gross Income includes the utilisation of the correct fee level together with a realistic occupancy rate.

In respect of annual expenditure, the most important item is staffing costs. Staffing costs can be up to 70% of gross income. They should not be above 55% - 60%, and if the actual staff costs are high, then the reasons for this higher figure should be investigated. In respect of other costs, comparisons with the last 2 - 3 years Annual Accounts should be made.

In terms of this approach to the value of the property, the final area which needs consideration is a suitable capitalisation rate. In the past, capitalisation rates at the lower end of the business enterprise spectrum have been used. With the changes that are taking place, I consider that the level of uncertainty will rise and thus it is inevitable that appropriate capitalisation rates will also rise. Accordingly, I consider that capitalisation rates for these types of property should be towards the upper end of the business spectrum capitalisation rates. These capitalisation rates should reflect future circumstances of the industry.

Often after having arrived at a total Going Concern value of a particular property, a client may require a breakdown of this figure as between land, buildings and other improvements, chattels and goodwill. Often this is required for mortgage and insurance purposes. Valuers who undertake this type of work should be competent in assessing realistic values on chattels and capable of compiling a comprehensive Chattels Inventory and ascribing suitable values to the individual chattels.

In respect of Goodwill, often a sum equating to one years future Attainable Profit has been used as a Goodwill sum. This has been found to be a realistic figure in the past. However, I would caution against blindly utilising this type of calculation in the future. This comment is particularly applicable because of the one year nature of Contracts at the present time. There may be very little Goodwill when valuing a property which has only six months to go in terms of the Contract with the local RHA. Also, the Contracts that I have seen have certain limitations in terms of business and client transferability. I also consider that it is prudent and appropriate that alternative use valuations be considered. There are a number of alternative uses to which rest homes and hospital type properties could be put, and these include back-packers lodges, boarding houses, student hostels, etc. I note that a former geriatric hospital with 4ha of land sold in Ashburton earlier this year at auction, for $187,000.00.

In my view the Health industry is going to go through a period of uncertainty in the near future as the government Health reform process takes effect. I believe the trend to Community Care is unwise. It would appear on the surface to be an exercise in cost cutting. In the short term it may very well cut costs. In the medium to longer term and for various reasons, I am of the view that there will be a swing back to institutional care.

Overall, I foresee some difficulties in the near future for the industry. Three to five years from now I foresee a refocused, lean, and very much rationalised Continuing Care industry.

# The Building Act 1991

## The Implications for Valuers

by D Sheard

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## GENERAL BACKGROUND

Prior to the passing of the Act each local authority had sole responsibility for regulating building activity within its territorial area. While model by-laws were promulgated there was scope for individual local authorities to make their own rules. This lead to considerable practical difficulty to the extent that properties in the same street which lay within different local authority areas, might have different requirements imposed for construction of identical elements of similar buildings. For example one local authority might require sewer systems constructed in a particular way, where as another local authority might require the system constructed in a quite different way. Clearly this situation was unsatisfactory.

During the 1980's the Building Industry Commission was established to examine the reform of building law. The Commission reported to the Minister of Internal Affairs in January 1990. It advised that regulatory intervention should be limited to:

- Provisions safeguarding people's wellbeing, where there was insufficient assurance that voluntary arrangements, such as market forces, self regulation or self interest would result in acceptable standards being achieved.
- Provisions protecting other people's property, including public property, that might be threatened by a building or building activity;
- Provisions relating to the national interest, to follow clear Government direction or reflect existing policies.

The report identified three ways in which building controls could be formulated:

- Through specific requirements stating precisely what must be done to comply, with building systems, components and methods specified and described in technical detail. Specific requirements have the advantage of precision and ease of administration. Each material and element of construction can be verified by cross checking, often by people with limited technical knowledge. Specific requirements have the disadvantage of undefined objectives, although detail in the control document may be extensive. There is therefore no incentive to seek alternative solutions. Technology is fixed at the time the control documents are written.
- Through functional requirements stating how the building must function but not specifying or describing in technical detail how the building is to be constructed or altered. Functional requirements have the advantage of allowing freedom of choice in fulfilling the stated purpose, but require interpretation to determine what is necessary to fulfil that purpose. Compliance is not certain without reference to some earlier document containing a "deemed to satisfy" solution. This solution tends to become the only solution to achieve the specific requirements.
- Through statements of performance defining the required performance of building or building components so as to satisfy any regulated functional requirement. As with functional requirements the method of achieving compliance is left open. The performance which meets the requirements is stated, leaving freedom to achieve that outcome in different ways. A performance based code that clearly states functional and performance requirements satisfies social objectives and the need to reach technical solutions to construction problems. It can readily accommodate change in technology and encourages innovation by providing freedom of choice in funding technical solution.

The Commission therefore recommended the establishment of a performance based code. Such Codes are generally structured as follows:

Purpose - Statements of the social objectives which the building must satisfy. These are usually expressed in terms of human needs such as protecting people or property from injury by fire, the provision of water which is safe for drinking or access for the disabled.

Functional Requirements Statements describing the functions of buildings and their components which are necessary to meet the social objectives. The requirement which recognises the need for protection of people or property from injury by fire therefore becomes a requirement to the "provision of safe means of escape" or "provision of fire protection (ie. sprinkler or alarm) systems".

Performance Criteria - Statements of the expected performance of buildings and their components that will fulfil the functional requirements. Examples of performance criteria are the fire rating of materials and the capacity of protection systems.

The Building Act 1991 is written in this background, and contains statements of purpose and functional requirements. It establishes a Building Industry Authority which has responsibility for publishing and reviewing the Building Code. The Building Code is a performance based code which applies uniformly throughout the country. Alternative solutions are permitted where performance criteria can be met. Local Authorities have no power to impose further conditions over and above the performance based criteria specified in the Code. The Act does not require that all existing buildings be upgraded to Building Code standard either at the commencement date of the Act (1 June 1992) or within any specified period of time after that date, although compliance may be triggered (as we will see later in this paper) by specific circumstances.

This paper was presented at the valuation seminar held at Lincoln University, Canterbury, on 30-31 August 1993.

# WORDS AND PHRASES

There are a number of words and phrases which are fundamental to an understanding of the workings of the Act. Some of the more important words and phrases are discussed below.

## Building

A "building" is defined as including structures, temporary or permanent, moveable or immoveable and extends to include any utility systems forming part of the structure whose proper operation is necessary for compliance with the Building Code. A "building" does not include such things as:

- Systems owned and operated by a network utility operator;
- Cranes, cable cars, ski tows and the like;
- Motor vehicles;
- Dangerous goods containers;
- Explosive magazines;
- Scaffolding or false work used in the course of construction;

Following this basic definition there are then extended definitions so that "building" also includes:

- Any part of a building;
- Any two or more buildings which, on completion of building work, are intended to be managed as one building with a common use and a common set of ownership arrangements.

At this point we strike the first of the difficulties under the Act.

- If a new building is to be constructed with a walkway connecting it to another building which was erected prior to the commencement of the Act, then "the building" must be made to comply with the Building Code i.e. at the time of construction of the new building, the old building must also be upgraded.
- Building work to part of a building may have an impact on the building as a whole. By way of example if the owner on the top floor of a high rise Unit Title development undertakes building work on his unit that work may trigger the application of those provisions of the Act which require upgrading of the whole of the building.

These extended definitions give rise to significant difficulties of interpretation in practice, well demonstrated by a recent example with which I had to deal. The problem related to a building erected in 1990 or thereabouts, to which was attached (as an integral part of the structure) a structure erected in 1920 or thereabouts. This structure had in turn been connected, in the 1950's, by a walkway to a third structure. The question arose whether or not we were dealing with one building or more than one building. Determination of the issue required a physical site inspection and a great deal of very careful analysis of decided cases in respect of similar legislation under the Town and Country Planning Act. At the end of the day I concluded that there were at least two buildings: one building comprising the original 1900 structure and the 1920 addition, and the other comprising the walkway and the "third" structure (although each of these was possibly a separate building). Hopefully my conclusions were correct.

## Building Work

Building Work is defined in Section 2 as meaning "work for or in connection with the construction alteration demolition or removal of a building and includes site work". Also in Section 2 "alter" is defined as meaning "to rebuild, re-erect, repair, enlarge and extend", with "alteration" having a corresponding meaning. These are very broad definitions. Needless to say there have not been any cases decided under the Act as to the meaning of these words. They have however been considered by the Courts both in New Zealand and in England in relation to other statutory provisions containing the same words. Care must always be taken when applying the interpretation given to the words in one statute, with the same words in a different statute with a quite different purpose, but such decisions can be of general assistance. The New Zealand and English cases to which I have referred, were almost exclusively decided in relation to taxing legislation relevant revenue statute. In the case *Customs & Excise Commissioners v Viva Gas Appliances Limited* [1984] 1 All ER 113, the English Court of Appeal considered an identical phrase ("construction alteration demolition") and, after talking about that rule of statutory interpretation which says that words bearing various shades of meaning can take their colour from the words which surround them in the statutory provision, went on to say "but here ... "construction" and "demolition" have no common colour for "alteration" which is sandwiched between them ... "demolition" far from sharing a common characteristic with "construction" is its antithesis. Once what constitutes the relevant "building" has been identified "construction" ... in the absence of any reference to "part of a building" means erecting a building as a whole and "demolition" means destroying it as a whole, so "alteration" is left to cover all works to the fabric of the building which falls short of complete demolition. I can see no ground on which the meaning of the ordinary English word "alteration" qualified by the adjectival phrase "of any building" should be construed as excluding any work on the fabric of the building except that which is so slight or trivial as to attract the application of the de minimus rule". It is hard to see what else the words might mean. Applying this interpretation therefore "building work" extends to include every conceivable form of building and demolition work, except perhaps work which is minor or trivial.

## Building Consent

This is the approval given by the local authority to building work. In common parlance it would be referred to as the building "permit". The building consent is the document which says that building work, if undertaken in accordance with the plans and specifications, will comply with the building code. "Building work" may not be undertaken without a building consent.

## Code Compliance Certificate

This is a certificate, issued under Section 43 of the Act, which states that completed building work complies with the Building Code. A Code Compliance Certificate can issue in respect of the whole of the work, or its specified parts, on an interim basis.

## Compliance Schedule

This is a document issued under Section 44 of the Act which lists those features of a building which require ongoing inspection and maintenance to ensure continuing compliance with the Code, and in respect of which a building warrant of fitness will be issued under Section 45 if the appropriate reports are obtained and provided to the local authority. The compliance schedule/building warrant of fitness provisions apply to buildings which contain features such as:

- Automatic sprinkler systems and automatic fire doors;
- Emergency warning systems for fire or other dangers;
- Emergency lighting systems and fire fighting systems;
- Backflow preventers for potable water supplies;
- Lifts and escalators;

- Mechanical ventilation or air conditioning systems;
- Emergency signs;

### Building Certifier

A building certifier is a person authorised by the Building Industry Authority to give certificates under the Act. For example, it is no longer necessary for the local authority to *check* plans and specifications lodged for a building consent, if they are accompanied by an appropriate certificate given by a building certifier that the plans and specifications comply with the building code. I am not aware that any person or company has yet been approved by Building Industry Authority as a building certifier.

### Producer Statement

Is a statement supplied by or on behalf of an applicant for a building consent that certain work will be or has been carried out in accordance with certain technical specifications. A common example of a producer statement will be an engineers certificate in respect of foundation design.

## HOW THE ACT WORKS

The Act applies to all buildings, including buildings erected by the Crown except defence buildings. Any person wishing to undertake building work must apply to the local authority for a building consent. If the local authority is satisfied that the plans and specifications for that work comply with provisions of the Building Code (and a building consent is necessary for that work) it will issue a building consent. When the work is completed a code compliance certificate will be issued with, where appropriate, a compliance schedule in respect of those building services which require ongoing inspection and maintenance. If the inspection and maintenance requirements of the compliance schedule have been fulfilled an annual building warrant of fitness is issued. Naturally enough if these procedures are not followed, not only are offences committed but also the building carries with it a contingent liability for the cost of any work necessary to comply with the code. In an extreme case where the defect is fundamental and "incurable", demolition will be the only option if the building is unsafe as a consequence.
The Third Schedule to the Act contains a list of certain types of building work in respect of which a building consent is not required. Anybody dealing with the Building Act on a regular basis needs to familiarise themselves with the various requirements of that schedule but for a valuer it is probably sufficient to note the following:

- The provisions of the Third Schedule of the Act as originally enacted were difficult to interpret and apply. The provisions of the Third Schedule were substantially amended by the building Amendment Act 1993 which came into force on 15 September 1993.
- "Like for like" repair or replacement work does not require a building consent unless it relates to:
  - items necessary for compliance schedule purposes;
  - structural components of a building;
  - components relating to the fire safety properties of the building;
  - components that have failed to satisfy the durability requirements of the code.
- The territorial authority may exempt work from the building consent regime if it is satisfied that a consent is not necessary because that work either:
  - is unlikely to be carried out otherwise than in accordance with the code;
  - if carried out otherwise than in accordance with the *code* is unlikely to endanger people or any building, whether on the same land or other property.

This power to exempt has caused and will continue to cause difficulties to Territorial Authorities and property owners alike. Arguably it is in sufficiently wide terms to exempt a broad range of building work from the operation of the Act. You will recall the comment in the *Viva Gas case,* where a reference was made to the "de minimus" rule. In essence I think these provisions are designed to cover the circumstances where work is of such a minor or trivial nature that it would be inappropriate for the Act to apply but the addition of the new "like for like" repair rules, challenge that conclusion. Time will tell how the Courts will interpret these provisions, and in the meantime it will be a brave local authority that extends its discretion in anything but the most obvious of cases. The prudent building owner wishing to make repairs or maintenance or do other minor work to his or her property should therefore discuss that work with the local authority before carrying out any work, to establish whether a building consent is in fact required.

## PITFALLS FOR THE UNWARY

### Section 38 Alterations

This section provides that where any alterations are made to a building for which a building consent is required, a building consent is not to be granted unless the building will:

- Continue to comply with the other provisions of the Building Code to at least the same extent as before the alteration.
- Comply with the provisions of the Building Code for the means of escape from fire and disabled persons access "as nearly as is reasonably practicable" to the same extent as if it were a new building.

An example of the operation of these provisions is where internal partitions are being altered in a building and the consequence of the alteration of those partitions is to cut off an effective means of escape from the premises. Such alterations are not uncommon in commercial buildings. Historically partitions alteration has not always been a matter requiring a building permit, unless it was work of a structural nature, and the recent amendments to the Third Schedule reinforce that position. If the wall is non-structural and it affects access, then it seems to me that will relate to the fire safety properties of the building and require a consent.
Disabled persons access is governed by Section 25 of the Disabled Persons Community Welfare Act 1975. As a broad generalisation all public and most commercial buildings must be provided with easy access for disabled persons at ground

level, specialist toilet facilities and, if the building is over 2 storeys, a lift. It is this last item which causes the most difficulty since the provision of lifts in older buildings will usually be uneconomic and often "impracticable".

Local Authorities do not have any discretion as to compliance with the provisions of the Disabled Persons Community Welfare Act. The only discretion lies with the Building Industry Authority. A recent publication from the Authority indicates that the authority is in some doubt as to its ability to grant dispensations. Any owner therefore wishing to undertake alteration work to an existing building erected before 1 June 1992 (or any building erected after that date which does not comply with current code standards) runs the risk that consequential upgrading work may be either uneconomic or perhaps even physically impossible. More importantly any building owner who agrees to make alterations to a particular building without first establishing the extent to which Section 38 might apply, runs the risk of serious contractual difficulties, for example where a landlord agrees to alter a building as a term of an agreement to lease the building.

### Section 39 - Specified Life Buildings

Where it is proposed that a building have a specified life the owner is required to state the specified life (not exceeding 50 years) in the building consent application and the building consent which issues will record that fact by way of a condition that the building is altered removed or demolished within the specified period. The only place where this condition is recorded is on the face of the building consent itself. You will appreciate that from a value point of view, a building with a specified intended life of say only 40 years will have been built to performance standards different to that of a building with a specified intended life of in excess of 40 years. No doubt the subtlety of this distinction would be reflected in any valuation of the property.

### Section 46 Change of Use

It is the duty of an owner of a building to advise the relevant local authority in writing if it is proposed at anytime to change the use of a building, where that change of use will require alterations to be made to bring the building into compliance with the Building Code or to extend the life a building that has a specified intended life in terms of Section 39. As in Section 38, where Section 46 applies the means of escape from fire and disabled persons access must be upgraded as near is as reasonably practical to new code standard.

The problem with this clause is knowing what is a "change of use". Clearly it is not something as simple as a change of tenancy. If premises are retail premises, a change of tenancy which does not result in any change in the nature of that retailing activity, will not involve a change of use. Equally clearly if premises, which have been used for retail purposes, are to be changed to residential purposes, then Section 46 will apply. Within these two extremes however there are a number of grey areas. For example if industrial premises are used for warehousing, is there a change of use if the new tenant proposes to use those premises for manufacturing purposes? In my view, depending on the nature of the manufacturing activity, there may well be a "change of use". Section 46 will however only apply if alterations are required to the building to make it suitable for that changed use. You will see therefore that while the section deals with changes of use, what really triggers the application of the section is the undertaking of alterations to accommodate that change of use. You would be forgiven for wondering if Section 46 actually achieves anything which could not equally be achieved by Section 38.

### Penalties

The Act provides substantial penalties for breaches of its provisions. For example, a conviction for use of a building which is unsafe carries a fine not exceeding $200,000.00 and in the case of a continuing offence a fine of $20,000.00 for every day that the offence continues. In circumstances where alterations are undertaken to a building (without a building consent) which have the effect of making a particular building unsafe and a loss of life follows. For example in a case where the owner permits an office building to be occupied for residential purposes and permits alterations to be made which do not comply with the Code, one could reasonably expect that the Courts will impose significant penalties. Penalties can be imposed not only upon the building owner or occupier but also in some circumstances upon the agents, employees and directors of the owner or occupier.

## IMPLICATIONS FOR VALUERS

In the majority of circumstances when you are asked to value a property, your task will be to establish a market value in either a sale or leasing situation. The case law as to the matters which you must consider in this area are clear. At the risk of oversimplification you are required to establish a value which willing, but not over anxious parties, would agree. In this exercise you are entitled to ignore matters which might impact on the decision making process of someone who is over cautious or who has unrealistic expectations. Put another way I think what the law requires you to assume is that the parties are both willing and reasonably prudent.

As a broad generalisation a solicitor considering the legal aspects of any particular property transaction would, historically, have only had regard to title and planning matters. Increasingly however in the last decade or so, solicitors have been making inquiries in relation to their clients' property matters on a broader front. Such inquiry always tended to be difficult however because of the reluctance or inability of some local authorities to provide information in a definitive and reliable way. To be fair to local authorities, such information as they provide does give rise to potential legal liability in the event that the information is incomplete or inaccurate, but the advent of the computer age has, at least at a theoretical level, greatly increased the ability of local authorities to provide comprehensive information in respect of particular properties. The 20th day of December 1991 was a significant date since it was the date upon which not only the Building Act but also the Local Government Official Information And Meetings Amendment Act (No.2) Act 1991 was given the royal assent. The former imposes upon local authorities clear obligations in respect of information gathering. Both Acts impose obligations in respect of the dissemination of that information to the general public.

Under the Local Government Official Information and Meetings Act, the local authority is required to provide a Land Information Memorandum and also under the Act a Project Information Memorandum.

Land Information Memorandum (LIM)

Within 10 working days of application the local authority must supply in respect of any particular property details relating to: Special features or characteristics of the land including the potential for erosion, falling debris, subsidence, slippage, inundation or the presence of hazardous contaminants, to the extent that the feature is know to the local authority but is not apparent from the district plan.

- Information on private and public stormwater and sewage drains.
- Information relating to rates owing in relation to the land.
- Information concerning any consent, certificate, notice, order or requisition affecting the land or any building on the land previously issued by the Territorial Authority (whether under the Building Act 1991 or any other Act).
- Information concerning any certificate issued by building certifier pursuant to the Building Act 1991.
- Information relating to the use to which that land may be put and conditions attached to that use.
- Information which, in terms of any other Act, has been notified to the Territorial Authority by an statutory organisation having the power to classify land or buildings for any purpose.
- Any information which has been notified to the Territorial Authority by any network utility operator pursuant to the Building Act.
- Any other information which the Territorial Authority may consider, in its discretion, to be relevant.

Most significantly the information contained in the LIM is deemed to be sufficient evidence of the correctness of that information, as at the date of its issue.

Project Information Memorandum (PIM)

An owner contemplating undertaking any building work for which a building consent is required can apply to the Council for a PIM. For these purposes "owner" includes any person who has agreed conditionally or unconditionally to purchase the land or any leasehold estate or interest in the land or to take an interest in the land, while that agreement remains in force. The local authority will require the owner to furnish with the application information likely to be relevant to the design or construction of any proposed building (or alterations to any buildings) in respect of such matters as:

- The intended use of the proposed building.
- The location and external dimensions of the proposed building.
- Provisions to be made for vehicular access.
- Provisions to be made when building over or adjacent to any road or public place.
- Provisions to be made for disposing of storm water and waste water.
- Precautions to be taken where building work is to take place over existing drains or sewers or in close proximity to wells or water mains.
- Such other information as may be required by any network utility operator in respect of proposed connections to public utilities for the proposed building work.

The Council having considered the application will then (within 10 working days of application) issue a PIM which will include:

- Information identifying special features of the land (erosion, fall debris, substance, slippage, likelihood of flood or the presence of hazardous contaminants) being a feature or characteristic which is:
  - likely to be relevant to the design and constructions or alteration of the building.
  - known to the Territorial Authority.
  - not apparent from the district plan.
- Information which in the terms of any other Act has been notified to the Territorial Authority by any statutory organisation having the power to classify land or any buildings for any purpose.
- Details of existing storm water or waste water utility systems which relate to the proposed building work or which are on or adjacent to the site of the proposed building work.
- Details of any of the requirements of the network utility operator relevant to the proposed building work.
- Either:
  - confirmation that subject to the other provisions of the building Act the building work may be undertaken upon obtaining a building consent and all other necessary authorizations; or
  - notification that the building work may not be undertaken because any necessary authorisation has been refused, notwithstanding the issue of any building consent.

Curiously there is no statement that the PIM is conclusive evidence of anything, nor is there any time limit for validity of the PIM. More importantly the PIM deals only with Building Act matters, it does not give any assurance that the proposed building will comply with the provisions of the district plan, which can be a significant and expensive trap for the unwary. While a PIM has value, it is therefore of a lesser value than a LIM.

The first and fundamental question is therefore whether or not it is appropriate for a valuer today when assessing market value for a property to do so without first obtaining a LIM, in respect of all properties, or a PIM, where new buildings or alterations to existing buildings are proposed? In my view the answer is quite clear. I do not see how a valuer can undertake the task of valuation unless he or she is fully and adequately informed as to all matters of public information available in respect of the property which might in some way impact upon the valuation. This is particularly true where the information disclosed is such as would influence a prudent purchaser or lessee. We will all remember occasions when in the past we have acted upon verbal information supplied by the local authority. While there has been an increasing willingness by local authorities to provide this information in written form over recent years, it is only since the implementation of the LIM procedure (ie. since 1 December 1992) that we now have a statutory provision which requires the local authority to stand behind the written information which it provides. Unless you have available to you on your file a LIM or PIM which you have obtained yourself, or which has been provided to you by the property owner, it seems to me that if the information upon which you base your valuation is incorrect then you do no more than expose yourself to potential for claim. This will be particularly true where a LIM or PIM would have disclosed information that would materially and significantly affect your valuation. For example:

- A LIM may disclose that a property is lfood prone (information which might not otherwise be available from an inspection of the property or from the district plan) will clearly affect your decision in respect of value. On a recent Christchurch City Council LIM for example we discovered that a property our client wished to purchase had a history of flooding during the early 1980's. That was a period when the water tables in Christchurch were exceedingly high. Similar levels have not been achieved for the last ten years, but the circumstances will doubtless reoccur at some time.
- A LIM will disclose details of any building permit or building consent and code compliance certificate issued in respect of buildings on the property. The standard agreement for sale and purchase in respect of property now contains a warranty by the vendor that building permits / consents (and code compliance certificates where appropriate) have been obtained in respect of building work undertaken by the vendor. If for example a code compliance certificate has never been issued in respect of building work, then market value may be affected, because

a subsequent purchaser would not wish to purchase a property carrying a "contingent" liability of that type.

You will appreciate, from the earlier discussion of the Building Act and from the nature of information to be provided on a LIM, that these examples are by no means exhaustive. How then do you deal with the practical problem of incorporating the information which is now available to you into your reports? There are four options:

- Make your valuation without obtaining a LIM or PIM, recording on the face of the valuation that the relevant memoranda have not been obtained. In my view this defeats the very purpose of the valuation and is unlikely to be acceptable in the market place generally and to the person who is paying your fee in particular.
- Require at the time of receiving instructions that you be provided with details of any LIM or PIM obtained in respect of the property. In a number of cases this information will already be available to your client. The difficulty with receiving that information from a third party would be knowing the extent to which, if any, the LIM or PIM supplied to you is complete. You need also to be careful when receiving a LIM from a third party to be satisfied that it is reasonably current. You will note the comment above that a LIM is only evidence that it is correct at the date of its issue. If too much time has passed between the time of issue and the time that you rely upon it, then there is an element of risk.
- Obtain a LIM or PIM for yourself and make your own analysis of the information disclosed. A PIM however is only available on the application of the owner. You can therefore only request the owner to obtain a PIM and then make your valuation once the PIM is available. In any case where you obtain a LIM you should discuss the matter with your client. Obtaining a LIM will involve your client in cost. In the absence of clear agreement with the client as to who is to meet that cost, difficulties in recovery of the cost may arise. Even then further difficulty arises if the LIM or PIM discloses matters beyond your area of expertise. Take the example of a LIM which discloses the presence of hazardous contaminants on the site. The assessment of the effects of such contamination is not a matter lightly undertaken by the unskilled. In some cases therefore, where the LIM or PIM discloses problems of a technical nature, it will be necessary to obtain assistance from experts, to help you analyse any consequential affect on values.
- Before undertaking your valuation require the owner to tell you the parameters within which you are obliged to make your valuation. This necessarily requires your client to make an assessment of the information disclosed on the LIM or PIM and to tell you what assumptions should be made. This will be appropriate where the client is fully skilled in making such assessments. It will be of no assistance to you in circumstances where you are instructed by a layman. If that eventuality arises then I recommend that as part of your instructions you obtain authority to consult with the appropriate experts where necessary. This may require you to have available a range of people from whom you can seek specialist advice such as an:

  Engineer;

  Architect;

  Building Certifier;

  "Independent qualified person" (a person approved by the Building Industry Authority for making inspections in respect of building warrants of fitness, for the purposes of establishing satisfaction of the requirements of a compliance schedule);

  Town Planner;

  (perhaps even) a Solicitor.

If these recommendations are followed inevitably the cost of your valuation to the client will rise. Some clients will resist the imposition of these additional costs. Other clients will however welcome the fact that your report is as comprehensive and as accurate as possible. Balancing these competing interests will not be easy. The trade off in my view is deciding whether or not it is acceptable to you to assume the risks of providing a report without doing the homework (with the potential for subsequent litigation) and not providing a report at all. In my view the answer (which is true for valuers and all other professional persons in the current market environment), is to seek quality of instructions rather then quantity of instructions, and quality of income rather than quantity of income. There is little point in being the best paid valuer in town, if you also have a significant contingent claims liability in respect of improperly prepared valuations.

In this regard may I point out by way of final comment, that most valuers currently insert on the face of their valuation reports various disclaimers designed to limit liability, sometimes to their own client, more often to third parties. The problem with such clauses is that:

- The Courts do not view exclusion clauses favourably in respect of the provision of professional services. They are invariably strictly construed.
- It is not possible to "contract out" of the liabilities which can arise under the Fair Trading Act or the Consumer Guarantees Act. The latter Act, which comes into force on 1 April 1994, creates a statutory guarantee as to reasonable care and skill in the provision of services (which necessarily includes valuation services).
- A limitation which is effective in limiting your liability will not of itself prevent you from being sued, with all the consequential expense and stress that goes with litigation. There is no substitute for getting it right in the first place.

# CONCLUSION

My purpose in this paper has been to touch upon the principal issues as I see them arising out of the Building Act for valuers. Of necessity the paper does not deal comprehensively with the statute, which is measure of 93 sections. In my overview I have omitted a number of matters which will have practical significance. For example the Act now contains a number of provisions, previously to be found in the Local Government Act, relating to the circumstances where buildings are erected over boundary lines or notices given by local authorities in respect of unsafe and unsanitary buildings. Such matters can often impact on value. I therefore recommend that all valuers must have at least a passing knowledge of the Act. For those of you who wish to pursue the matter further can I recommend to you the book "A constructive guide to the New Zealand Building Act" published by CCH New Zealand Limited which contains a very informative overview of the provisions of the Act, as well as the text of the statute itself. This text in my view should be an essential part of every valuer's library.

# Rental Incentive Analysis

by C C Barraclough

*Chris Barraclough is the Christchurch principal of Darroch & Co., and he specialises in the valuation of commercial and industrial properties and in business valuations. He is an associate of the NZ Institute of Valuers and holds a B Com from Auckland University.*

Since the beginning of 1988 but more particularly subsequent 1990, there have been numerous instances of lessors of new, refurbished or existing office buildings providing incentives in order to attract and/or free existing tenants and entice them to occupy space in a particular building.

The more typical incentives are

- Fitout provision
- Cash sum
- Rent free periods
- Taking over existing lease obligations

Such incentives are commonplace in the office market and are an obvious reflection on the continual over-supply. To a lesser extent there are examples in the industrial sector, however I am not familiar with any incentives being granted to tenants in the retail sector other than for a relatively short-term, rent free period whilst the lessee completes the fitout. To my mind a rent free period of this latter nature would be categorised as a normal market arrangement and would not count as an incentive in the same context.

Initially amongst valuers there was a perception that the market rent was unaffected by the incentive paid and that the incentive did not impact upon market rental. Valuers, lessors and lessees are now in agreement that incentives do push nominal rentals above market and that those nominal rentals need to be adjusted to reflect the real transaction. The first arbitration award to be published which crystalised the thinking on incentives and the impact on market rent was the Wellington arbitration of AMP Society and Watpat Nominees before Peter Mahoney, valuer, of Auckland. Mr Mahoney's award was published in March 1992.

It is essential that valuers uncover the full circumstances pertaining to a leasing. This may mean talking to the parties and to the agent involved. It is rarely enough to sight a lease, but even when sighted, incentives are seldom documented in the lease. As the forerunner to the AMP/Watpat arbitration

Example 1

| | | |
|---|---|---|
| Contract Rent | $166,548 | |
| Area sq m | 859.60 | |
| Contract Rent per sq m | $193.75 | |
| Commencement Date | 25 March 1991 | |
| Term | 10 years | |
| Renewal | 10 years | |
| Review Frequency | 2 years | |
| Fitout Provided by Lessor | $430,770 | |
| Calculation Approach Using an HP 18C | | |
| FIN | | |
| TVM | | |
| Clear All | Clears existing cash flows | |
| Other | # Payments/yr @ 12 | |
| | Begin mode | |
| Exit | Returns to TVM menu | |
| Enter Data | 120 N | |
| | 12I%YR | |
| | PV $430,770 | |
| | PMT to calculate | $6,119.00 |
| The equivalent rent per annum | | $73,428.00 |
| The equivalent rent per sq m per annum | | $85.42 |
| Market rent for comparative purposes becomes - | | |
| Contract rent per sq m | | $193.75 |
| Less present value of incentive | | $85.42 |
| Effective Rent | | $108.33 |

PVMADV1.XLS

| | A | B | C | D | E | F |
|---|---|---|---|---|---|---|
| 17 | PV Monthly In Advance of Present Lump Sum | | | | | |
| 18 | i | 12.00% | 0.01 | $430,770 | | |
| 19 | n | 120 | 119 | | | |
| 20 | Rent/pa | $73,429 | $6,119.11 | | | |
| 21 | B20=C20*12 | | | | | |
| 22 | C18=1318/12 | | | | | |
| 23 | C19=B19-1 | | | | | |
| 24 | C20=(DI8*(Cl8*((l+Cl8)' C19))/(((I+C18)AC19)+(Cl8*((1+C18)^C19))-1)) | | | | | |

This paper was presented at the valuation seminar held at Lincoln University, Car terbury, on 30-31 August 1993.

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the Court of Appeal upheld the decision of the High Court in refusing to set aside subpoenas for full discovery of the background to the comparable lease agreements.

Having established that an inducement has been provided in some guise how then does this impact on our rental analysis to determine market rent? The requirement is to convert the incentives to rent equivalent. The critical question is over what period of time should the incentive be annualised?

- for the period of the first review
- for the estimated period of total occupancy
- for the term certain of lease

The consensus is for the term certain before renewals.

This rent equivalent is then deducted from the nominal or contract rent to derive a real or effective rent on an uninduced basis.

This effective rent is largely accepted as the market rent for the purpose of rental comparison, assuming of course that the letting reflects a willing lessor/willing lessee scenario.

Four working examples follow:

For simplicity I work on a net rent basis, however in reality we should be adding on for operating expenses and completing the analysis on a gross occupancy cost basis.

With reference to Example 1 (PVMADV1).

The time certain is 10 years. The exercise of the renewal cannot be assumed. The requirement is to deflate the contract rent by the deemed rent equivalent of the fitout incentive over the initial 10-year term of the lease. It is not correct to simply divide the incentive by the ten years. We need to look at the time value of money and it will be necessary to discount at an interest rate to determine present value.

What we must determine therefore is that sum of rent equivalent payable monthly in advance which over the ten years equates a present value of $430,770. Obviously this is going to be something more than a straight pro rata of the $430,770. The value of receiving $430,770 or its equivalent now as a lump sum incentive is significantly greater than that same sum spread evenly over 10 years. Having established what is required we must initially decide on the appropriate interest or discount rate.

In my view the discount rate must be related to an interest rate applicable at the date of the lease comparable. This is what would have been paramount in the minds of the parties at the time they did the deal. It is not necessarily the discount rate applicable at the date of the rental valuation for which the market analysis is being completed.

It is something more than a yield available from long term government stock but something less than a first mortgage interest rate. The opportunity cost to the lessee is the cost of borrowing a lump sum to complete a fitout. I suggest that the discount rate be related to the cost of a commercial funding facility such as a 90-day bill rate.

The date of Example I is March 1991, the then bill rate 11.95% say 12%.

Having established the time certain and the discount rate the calculation options are on a business calculator or on a spreadsheet as I do personally. With reference to Example 1, the calculation is initially on an HP18C, and secondly on my spreadsheet format shown PVMADVI. I have illustrated the formulas for the respective cells should you wish to utilise them. As an alternative you can utilise the financial functions which are programmed in Excel for example.

A possible dilemma is whether the inducement should be analysed from the perspective of the lessee or lessor? From the lessee's viewpoint he receives the benefit of the fitout and is effectively paying extra rent for the benefit, the rental cost of which is tax deductible. Obviously any analysis proceeds on the basis of the pre-tax cost. From the lessor's perspective the lessor has the benefit of depreciating the fitout, receives a tax benefit accordingly and may, if the lease term is not too long and he is lucky, retain some residual value in fitout.

The true cost to the lessor is therefore the lump sum advanced less the present value of the tax benefits from depreciation write-offs along the way less the present value of the residual fitout worth. I understand that this approach is followed by some valuers in Wellington however it has limited acceptance, requires assumptions to determine the depreciation rate given the varying rates that are available for different categories of fitout and possibly requires assumptions in respect of the tax rate. I am aware however that where the lessor retains ownership, the tax benefits have been a factor in their decision.

## Example 2

| | |
|---|---|
| Contract Rent | $45,333 |
| Area sq in | 300.83 |
| Contract Rent per sq in | $150.69 |
| Commencement Date | 1 November 1992 |
| Term | 10 years |
| Renewal | 5 years |
| Review Frequency | 3 years |
| Fitout Provided by Lessor | Already in place |

Option 1

As for Example 1

Requires an initial assumption as to its cost replacement worth, say $250 psm, $75,000.

The equivalent rent per annum to furnish a present value of $75,000 over 10 years at 6% is $9,942.

This is rent equivalent of $32.72 per sq in.

The effective market rent for comparative purposes becomes

| | |
|---|---|
| Contract rent per sq in | $150.69 |
| Less present value of incentive | $32.72 |
| Effective Rent | $117.97 |

Option 2

I prefer to make some value judgement, say $20.00 per sq in, the effective rent for comparative becoming $130.70 per sq in.

it

Had the lessee in the example received $430,770 as cash to fund their own fitout is the basis of analysis any different?

Provided that the cash sum is tax free in the hands of the lessee, then there are obvious benefits in the lessee receiving cash, as in addition they will benefit from the tax break on the depreciation of the fitout which they will fund and own. One can therefore argue that any cash incentive needs to be adjusted upwards by that tax break on the depreciation. In my experience however, the majority of the incentives are fitout rather than cash and I am not aware of any examples where a distinction has been made in the analysis between a fitout incentive and a cash incentive.

The implications of tax on the analysis of incentives were fully explored in the AMP/Watpat arbitration. It was recognised that the tax implications could have differing results from the perspective of the lessor or lessee, that is the tax may be particular to individuals and not the market as a whole. The tax argument was expounded from the lessee's viewpoint. Peter Mahoney concluded that a fair market rent be the amount to be paid by the willing, but not over-anxious lessee, to a willing but not over-anxious lessor, untainted by any ancillary considerations.

Potential tax implications were disregarded and this is the basis on which any incentive analysis should proceed. A cash incentive is treated as for Example 1.

Is there a distinction in the analysis between a fitout provided or cash provided for a fitout vis a vis a lessee walking into an existing fitout? I consider there is.

With Reference to Example 2.

I do not treat existing fitout as an incentive but rather I quantify that fitout by considering what the willing lessee would pay for fitted out space. In other words I determine a market rent for the fitout rather than complete a financial analysis. This may obviously have a significant affect on the analysed rental.

With Reference to Example 3 (PVMADV3)

The critical component in a rent free period is the duration of rent free period that a tenant could normally expect to receive as a fitting out period. What we are required to adjust for is what Rod Jefferies calls an "abnormal rent free period".

Example 3

| | |
|---|---|
| Contract Rent | $113,237 |
| Area sq in | 701.33 |
| Contract Rent per sq in | $161.46 |
| Commencement Date | 6 April 1992 |
| Term | 5.75 years |
| Renewal | 6 years |
| Review Frequency | 3 years |
| Rent Free | 1 year |
| Normal Rent Free | 2 months |

The requirement is to assess the present value of the rent payable monthly in advance for years 2 through 5.75 inclusive, defer for one year less two months to the present day and determine the rental equivalent of that present value monthly in advance over the full 5.75 term certain of the lease.

The calculations have been done on my simple spreadsheet.

| | |
|---|---|
| Present value of $113,237 for 4.75 years at 7% | $459,134 |
| Present value of $459,134 deferred 1 year less 2 months at 7% | $433,963 |
| Present value per annum for 5.75 years at 7% of $433,963 | $91,361 |
| Present value per sq in per annum | $130.27 |
| Market rent for comparative purposes becomes | $130.27 |

PVMADV3.XLS

| | A | B | C | D | E | F |
|---|---|---|---|---|---|---|
| 1 | PV Monthly in Advance | | | | | |
| 2 | i | 7.00% | 0.005833333 | $459,134 | | |
| 3 | n/months | 57 | 56 | | | |
| 4 | Rent/pa | $113,237 | $9,436.42 | | | |
| 5 | C2 = B2/12 | | | | | |
| 6 | C3 = B3-1 | | | | | |
| 7 | C4=B4/12 | | | | | |
| 8 | D2=((((((I+C2)^C3)-I/(C2*((1+C2)^C3)))*C4)+C4) | | | | | |
| 9 | | | | | | |
| 10 | PV Future Lump Sum | | | | | |
| 11 | i | 7.00% | | $433,963 | | |
| 12 | n | 10 | 0.833333333 | | | |
| 13 | Capital Value | $459,134 | | | | |
| 14 | C 12=B 12/12 | | | | | |
| 15 | DII = (I /(((1 +B11)^C12))*B13) | | | | | |
| 16 | | | | | | |
| 17 | PV Monthly In Advance of Present Lump Sum | | | | | |
| 18 | i | 7.00% | 0.005833333 | $433,963 | | |
| 19 | n | 69 | 68 | | | |
| 20 | Rent/pa | $91,361 | $7,613.39 | | | |
| 21 | B20=C20* 12 | | | | | |
| 22 | C18=B18/12 | | | | | |
| 23 | C19=B19-1 | | | | | |
| 24 | C20=(Dl8*(C18*((1+CI8)^CI9))/(((1+C18)^C19)+(C18*((1+C18)^C19))-l)) | | | | | |

With reference to example 4 (PVMADV4)

The remaining common incentive is where the lessor takes over the lessees existing lease obligations. Some valuers maintain that where the lessor has assumed the contractual lease arrangements of the former premises of the lessee, that the run-on costs associated be ignored for the purpose of determining effective rent.

The rationale behind the exclusion is that first the run-on cost is a contingency and can only be quantified accurately in hindsight (there is always the possibility of the obligation being reduced by a sub-letting) and second, if the lessee had been free to move (not bound by an existing contractual arrangement), such lessee could not and would not expect to receive anything more than he is going to receive anyway by way of a rent free period and/or fitout package. Provided that the lessee receives his expectation of what the market will provide, the ongoing contingent lease costs as affecting the cashflow returns to the lessor can hardly be construed as a function of market rent for the new premises. They are simply a cost to the lessor of freeing a tenant for the market.

Is this an incentive? The balance of valuation opinion is to adjust the rent so as to reflect the benefit to the lessee of being free of his previous lease obligations.

In all four examples that I have illustrated the analysis assumes that market rent remains less than contract/ratchet rent for the duration of the term certain. Should market recover to be in excess of contract within the duration of the term certain then we need to build in an inflationary factor and account for a future rental increase above ratchet. The effective rent will therefore increase by the present value of the escalation in rental beyond ratchet.

Having established the correct basis of analysis for the various common tenant inducements, valuers must be aware however that in the current strengthening market the fitout deal may not be an inducement at all. The lease documentation must be checked. The lessee may in fact be paying rent for fitted out space, the inducement merely that the lessor is providing the initial fitout funding, with the inducement not being an enduring benefit for the term of the lease and at review the premises to be valued as fitted out space.

Example 4

Circumstances as for Example 1.

In addition the lessor assumes the contingent lease liability associated with the lessee's prior lease contractual arrangements which are yet to terminate.

The lease has 6 months to run and the contract rent plus operating expenses is $75,285 per annum.

The incentive is equivalent to the $75,285 per annum for the 6 months discounted at the 12% and spread over the 10-year term of the new lease.

| | |
|---|---|
| Present value $75,285 pa monthly in advance at 12% | |
| for 6 months | $36,723 |
| Present value per annum for 10 years of $36,723 | $6,260 |
| This equates $7.28 per square metre per annum. | |
| Market rent for comparative purposes becomes - | |
| Market rent analysis as for Example 1 | $108.33 |
| Less present value of the lease contingency | $7.28 |
| Effective Rent | <u>$101.05</u> |

PVMADV4.XLS

| | A | B | C | D | E | F |
|---|---|---|---|---|---|---|
| 1 | PV Monthly in Advance | | | | | |
| 2 | i | 12.00% | 0.01 | $36,723 | | |
| 3 | n/months | 6 | 5 | | | |
| 4 | Rent/pa | $75,285 | $6,273.75 | | | |
| 5 | C2 = B2/12 | | | | | |
| 6 | C3 = B3-1 | | | | | |
| 7 | C4 = B4/12 | | | | | |
| 8 | D2 = ((((((1 + C2)^ C3) -1 /(C2* ((1 + C2)^C3))) *C4) + C4) | | | | | |
| 9 | | | | | | |
| 10 | PV Future Lump Sum | | | | | |
| 11 | i | | | $0 | | |
| ! 12 | n | | 0 | | | |
| 13 | Capital Value | | | | | |
| 14 | C12=1312/12 | | | | | |
| 15 | DI 1=(1/(((1+B1I)^C12))*B13) | | | | | |
| 16 | | | | | | |
| 17 | PV Monthly in Advance of Present Lump Sum | | | | | |
| 18 | i | 12.00% | 0.01 | $36,723 | | |
| 19 | n | 120 | 119 | | | |
| 20 | Rent/pa | $6,260 | $521.65 | | | |
| 21 | B20=C20* 12 | | | | | |
| 22 | C18=B18/12 | | | | | |
| 23 | C]9=1319-1 | | | | | |
| 24 | C20=(D18*(C18*((1+Cl8)^C19))/(((1+C18)^C19)+(C18*((1+C18)^C19))-1)) | | | | | |

# Valuing Resource Consents

by C S Croft

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Resource management consents, or formerly town planning consents, are not new to valuers. They have been a part of valuation methodology for the last few decades. The number of consents is now greater under the Resource Management Act 1991 (RMA) and the nature of consents is more complex than in previous legislation.

The objectives of this paper are to:

1. Clarify the definition of the value of consents.
2. Highlight how the nature of the consents impacts on the valuation methodology.
3. Clarify the value components of consents in respect of improvements and land value.
4. Summarise the impacts on the valuailon of property.

## 1. Definition of the Value of Consents

On the face of it, this appears relatively straight-forward in relation to consents attached to land.

"the extra amount of hypothetical sales price paid because of the presence of the consent(s)".

However, this over-simplified definition becomes more difficult as the valuer attempts to determine " the extra amount". The base over which the extra amount applies also needs to be determined. The land without the consent and without the prospect of ever getting a consent or the land without the consent but with the chance of obtaining the same or a similar consent are different and require a determination.

Obviously, the land with the chance of the consent that has the potential allowing change to another use will be worth more than the land with no prospect. This holds, provided the use with the consent generates more income or utility (i.e. the consent is associated with the land use maintaining or changing to the highest and best use).

The problem with this definition is that the POTENTIAL of the land (e.g. to be irrigated, to be subdivided) must be recognised and incorporated into the value regardless of whether the owner has or intends to apply for any resource consents. The "extra value" of the consent itself is the component of value associated only with the confirmation of that potential in the land. The land potential also becomes an important valuation consideration with consents which are for a limited time period requiring renewal for the use to continue. Land use consents and subdivision consents usually have unlimited duration but coastal permits, water permits and discharge permits have a specific duration (max 35 yrs, default 5 yrs) and can also lapse, be cancelled or reviewed.

Where the consent is terminating and the use is dependent on that consent then the chance of replacing that consent with a similar one at the expiry must also be considered by the valuer. So the existence of the consent at the time of valuation is only one factor. The chances (potential of the land) of obtaining similar consents both now and in the future must also be assessed.

*"The assessment of the potential of the land can only be made in the knowledge of the process and the chances of getting the necessary consent"*

It is essential for the valuer to know Part VI Sections 87-121 (especially Sec 104 relating to decisions) of the RMA. The assessment of the potential of the land can only be made in the knowledge of the process and chances of getting the necessary consent.

The assessment of the potential of the land can only be made in the knowledge of the process and the chances of getting the necessary consent

Along with the other factors such as:

- the physical and legal attributes of the land to be valued.
- the availability of other land for that use.
- the demand for that use.
- any policy statement issued.
- the district and regional plans.
- prevailing society attitudes to the activity.
- persons likely to make submissions on any consent application.

## 2. The impact of the nature of Consents in Valuation

Essentially the consents are granted with many conditions imposed on their "ownership". In broad terms the Act provides rights to resources more akin to custody rather than full ownership (Sec 122). The rights granted vary widely in the Act, from consents which are non-terminating, freely tradeable economic instruments (in the case of some coastal consents), to terminating consents with conditions and a review process.

The significance of this is that some consents will:-

1) attach to the land by expressed statement, and are transferable with the land. (Sec 134 (1)) e.g. Land use consent, subdivision consents.

2) attach to the land by default. An instrument representing the right

This paper was presented at the valuation seminar held a; Lincoln University, Canterbury, on 30-31 August 1993.

exists (the permit) but is not transferable without the land and the activity is site-specific e.g. discharge permit.

3) be a freely tradeable economic instrument and does not attach to land or any other instrument e.g. some coastal permits, some water permits.

In theory the amount of value of the consent is the net resource return or resource rent which that consent allows for the duration of the consent (where terminating, plus the chance of replacement; less the costs of obtaining the consent). The underlying theory of land value is based around the highest and best use (or most probable use) and the residual land rent which accrues to the land. The value of resource consents can also be based on the residual rent theory.

Definition of Land Rent:- The economic return that accrues or should accrue to land for its use in production (Barlowe 1986). Any land component, whether it be an improvement or a consent, that contributes to the land rent, will increase the value of that land (this includes future residual returns or potential). Provided always that the costs do not exceed the returns, (positive land rents), and provided also that the component attaches to and is part of the land.

Where the resource consent creates an interest in a transferable economic instrument, and where the benefits or resource rents exceed the costs, then that instrument will have a value (either in its own right or as part of a business).
The basic methodology of valuation to establish the highest and best use, or most probable use, of the land remains the cornerstone of the whole process. With the RMA the valuer must now consider the impact of any consents needed to achieve the highest and best use and the costs of obtaining those consents (costs include the costs of effects of any conditions imposed and is the cost at the time of the valuation) to value land accurately.

## 3. Value components of resource consents in respect of improvement and land value.

While many of the valuations completed will not be statutory, the use of statutory definitions and the associated caselaw is a good, sound foundation for valuation procedure. In assessing market value it is not usual to split the property attributes into "Land Value" and "Value of Improvement" as defined in The Valuation of Land Act 1951. Most valuers will however categorise the value components on a general definition, if only for the purposes of the analysis of the comparable sales. However, for support for the split of value components, there is no substitute for the statute and caselaw. In most cases the precise definition is not mandatory, however, what is critical is that the analysis of sales is consistent in respect of the variables removed in the analysis process and the composition of the residual between all the sales and the subject to be valued.

The caselaw which appears to set the precedent is the McKee v Valuer General Case, Court of Appeal September 1970. This was an appeal against a decision on an objection to roll values in Upper Hutt. The objection revolved around the valuation of a multi-unit block of flats built with a conditional use consent in an area zoned residential. The question to be determined was whether the Valuer General had acted correctly in including the extra value of the property (to the grant of consent of conditional use) in the unimproved value of the land.

In summary, the Court of Appeal ruled that

1) the valuer is required to value the unimproved value (land value or vacant land) as if the consent had not been obtained.

2) The assessment of the unimproved value (land value or vacant land) is without the consent BUT with the chance of obtaining a similar consent (incorporating the property attributes, legal framework and social factors prevailing at the time).

3) The difference between the total capital value with consent, and the value of the land with merely the chance (of obtaining a similar consent), is part of the improvements i.e. the market assessed chances of confirming the consent(s) are contained in the unimproved value (the potential) and the process of obtaining the consent is contained in the improvements.

This process of allocating the confirmation of consent as an improvement conforms to the statutory definition of improvements as contained in Sec 2 of the Valuation of Land Act 1951. It is work done on or for the benefit of the land in the expenditure of labour or capital and does increase the value of land.

The improvement component is a market assessed "cost" of obtaining the consent including the cost of the nature, duration and conditions which may be imposed in the consent. Note that this improvement component may or may not be represented on the land by a physical structure. e.g. The old existing use right to replace a burnt out or demolished dwelling.

## 4. Summary of Impacts on Valuation

4.1 The full extent of the complexities created by the Resource Management Act for valuers is yet to be determined. New District and Regional Plans are yet to be produced providing the rules which will regulate the activities. The extent and nature of those rules will regulate what activities will require consents and these have not been created yet. Currently we are operating on interim plans which are essentially modified district schemes created under the Town and Country Planning Act 1977. While these old schemes, the RMA and some policy statements already published, are a good indication of the likely content, we must await the regional and district plans for the rules.

4.2 It follows that the valuers must have a good knowledge of the rules in the various plans in the districts in which they value. The valuer must also be aware of the processes and costs of obtaining the range of consents to change the activities or uses on land. It is this component which will comprise the improvements PROVIDED the change in use can generate land income which exceeds those costs (additional land rents).

4.3 In the analysis of sales the consents relating to each sale must be known. This includes the duration, conditions imposed and transferability. If the sale is an important comparable then the use of the sale can only be useful with the consent information known. The only reliable source for this information is the issuing authority both for the existing consents and the chances of obtaining consents.

4.4 The valuer needs to become sensitive to the social attitudes to the land and resource use. The people (objectors) who are likely to oppose consents and in particular the meaning of the "best practical option". All people have rights of submission to the creation of plans and to make submissions on consent applications.

*"Valuers must have a good knowledge of the rules in the various plans in the districts in which they value"*

In conclusion, it is important not to lose sight of the process of interplay between land development use and the protection of the physical social environments - The Resource Management Act is the basis of this process, the rules and consents are a part of the checks and balances and may have a significant impact on the value of land.

# Understanding Forestry Valuations

by P.E. Tierney

*Peter Tierney is a Fellow of NZIV and has been a member of the Valuers Registration Board since 1984. He is the senior partner of Jones Tierney & Green, registered public valuers of Tauranga, and he has been involved in major valuation assignments for compensation, forestry and rural properties. Mr Tierney has been a former President of NZIV and was a councillor for ten years.*

I do not claim to be an expert on growing exotic trees but I have had a lifetime associated with the valuation of the land on which trees grow and have kept and logged many sales of land containing, in the main, Pinus Radiata. The theme of this paper is Forestry Syndication which has become a popular avenue of investment in recent years, with numerous partnership opportunities currently available. I have severe reservations that in pure valuation terms the budget projections set out in a prospectus for a forestry investment syndicate should be called a valuation. Certainly those that invite participation from the time of first planting are really budgets, charting out how, why and where the investors collective investments should be spent.

"The theme of this paper is Forestry Syndication which has become a popular avenue of investment in recent years with numerous partnership opportunities currently available. I have severe reservations that in pure valuation terms the budget projections set out in a prospectus for a forestry investment syndicate should be called a valuation."

The authors are, in many cases, highly regarded as forestry managers and experts whose skills are obvious by the careful documentation of their projected figures both of expenditure and income. For example, two in my possession prepared by P.F. Olsen and Company and Chandler Frazer Keating are, in my opinion, models of clear explanations and detailed reasoning. There are sure to be others in the same category but I regret to say many others do not reach that level.

One of the important features, to me, is the distancing of these experts from the promoters and in the two mentioned above there is a clear line drawn between the two. Others are less clearly defined and in some instances the budgets appear to be the work of the promoters. If you are advising a client on an investment then check that the projections are done by a disinterested professional, preferably a member of the N.Z. Institute of Foresters. The prospectus should also preferably include a valuation of the land component prepared by a member of the N.Z. Institute of Valuers.

I wish to comment also on the type and value of the properties being purchased for afforestation. My experience is that anything within reasonable range of a market or port should, pre-1993, lie within the range of $700-$1,500 per hectare, but there could well be properties outside that range either in less favoured localities or as strategic purchases. 1993 levels in the Bay of Plenty have increased to $1,500-$2,000.

Properties with a large component of buildings, unless they can be subdivided off and sold, increase sharply the plantable per hectare effective rate. The effect of the Resource Management Act 1991 could be profound and should be addressed in a prospectus. I venture to suggest there are some ecologically sensitive but yet to be discovered locations in such places as the Coromandel and Marlborough Sounds.

It is customary in prospectus documents to demonstrate the real return that will accrue to the investors at the termination of the first tree crop in twenty-five to thirty years time, with the land being then notionally sold or replanted. The rate of return percentage which the investment will yield is calculated on the basis of discounting costs and income so that when they reach equilibrium the percentage is known as the IRR or internal rate of return. It is normally on a non-inflation basis and demonstrates what rate of return the total investment will yield on a compounding basis.

A simple example will suffice.

Table I

| Year | | Cash Flow | Present Value (10%) |
|---|---|---|---|
| 0 | Land | -1000 | -1000 |
| 1 | Planting | -500 | -452 |
| 2 | Releasing | -100 | -82 |
| 20 | Tree crop | +10800 | +1466 |
| 20 | Land | +500 | + 68 |
| | | | 0 |

or an IRR of 10% true

You will notice in this simple illustration that the land component comes in at a plus value at the time of harvest. The calculations used in the prospectus are of course highly sophisticated computer based programmes that accommodate all the variations in forestry growing and harvest.

Prior to 1993 it was generally considered that most investments should fall within the 8%-10% range and indeed many of the issued prospectus are within this range.

This paper was presented at the valuation seminar held at Masey University, Palmerston North, on 16-17 August 1993.

Table 2

| Forest | Area (Ha) | Location | 1111 1% |
|---|---|---|---|
| Greentrees | 246 | Whangarei | 9.05 |
| | 232 | Whangarei | 9.10 |
| Eskdale | 317 | Napier | 9.56 |
| Awaroa | 601 | Kaitaia | 12.00 |
| Kaheka No.1 | 206 | Napier | 8.62 |
| Bayview | 393 | Napier | 8.90 |

The forestry consultants in the three Napier examples observe that their figures of 8.90%-9.56% represent a high rate of return by forestry standards. The 1993 rate of return has increased to from 9.6%-10.4%.

## What to Look for in a First Time Planting Partnership

There are four major factors in this writer's opinion.

1. Distance from market/mill/wharf.
2. Site index or growth potential.
3. Slope.
4. Access to Class I roads.

Distance from mill and/or port is important. In quite recent times major forestry interests have been looking for land within 60 kilometres of an export port as road haulage costs are considerable at around $0.18c. per cubic metre per kilometre. A problem emerging in recent times is access to the State Highway system as some Local Authorities are requiring the owners to upgrade at their own expense Class II roads before extraction will be permitted.

Site index is a term frequently seen and experienced foresters go to some length to validate their choice of an index number. It is the mean height of the tallest 100 trees per hectare at age 20. Generally a high site index is on low altitude sites in a good rainfall area. All other inputs being equal, the higher the site index the greater the volume of timber at harvest. The estimate forms the cornerstone of the calculations of the amount of potential income. It is analogous with butterfat per hectare or ewe equivalents per hectare.

The final item is slope, which dictates extraction costs. Hauler logging is more expensive than tractor or skidder by as much as 30%-40%.

Established Forests

There are currently several partnership offerings where the trees range from 15 years to 23 years and the method of arriving at the crop value is to discount the expected nett harvest return by an accepted discount rate - 10% appears to be generally used.

Comparable Sales

The writer has been waiting for many years to see a prospectus that actually quotes sales of blocks containing trees in support of the value levels used. The budget method of producing a value for economic farmland was used many years ago under the Land Sales Act and finally met its fate because of

(a) an inflexible capitalisation rate, and

(b) it was too easy to fiddle the figures.

Since then all valuations undertaken for real property have as their basis the Willing Buyer Willing Seller concept which has stood the test of any number of Court decisions. This means that both parties are prudent and informed and this concept enables a valuer to discard or discount sales that do not fall within the guidelines.

Strangely enough the sales collected by the writer over a number of years are at lower levels than those currently used by foresters. In an address to the Bay of Plenty Branch of the N.Z. Institute of Valuers in August 1990 Mr J. Cawston produced the following figures per hectare.

Table 3

| Year | Forest Company | M.O.F. Figures | V.N.Z. Figures |
|---|---|---|---|
| 0 | 500 | | 500 |
| 5 | 2,000 | 2,900 | 1,600 |
| 10 | 4,000 | 4,300 | 2,700 |
| 15 | 6,200 | 6,300 | 3,800 |
| 20 | 9,000 | 9,200 | 5,000 |
| 25 | 12,500 | 13,600 | 6,200 |
| 30 | 18,000 | 20,000 | 7,200 |

Mr Cawston's view was that investors might buy on potential but are dreadful sellers. The writer's experience was more akin to Valuation New Zealand's and a further study conducted by Valuation New Zealand consequent on Cyclone Bola on the East Coast produced sales a little, but not significantly, higher.

The State Forest Assets sales produced some great basic data for Valuers, e.g.

Table 4

| | Area | Price | Per Hectare |
|---|---|---|---|
| Ernslaw One | 23801 | $102M | $4,285 |
| T.F.L. (Nelson) Ltd | 49852 | $262M | $5,255 |
| C.H.H. | 92704 | $383M | $4,131 |
| J. Nissho Ltd | 43531 | $125.55M | $2,883 |

Mr John Keating of Rotorua suggested that the average sale price for all sales was $4,163 per hectare and the averaged age 12-14 years. If you compare his estimate with the figures in table 3, it is reasonably consistent with the age class values of the Forest Company and the Ministry of Forestry.

## Conclusions

The writer would like to see a greater expansion of the market related data included in the valuations of the various prospectus. It is also well past the time when the NZIV should institute a system of gathering, analysing and distributing details of the sales of forestry rights.

There are an increasing number of farm properties where under today's prices a not inconsiderable portion of their market value is in plantations. An example might be Erewhon Station.

# LEGAL ISSUES

## CONSUMER GUARANTEES ACT

by Michael Burrowes and Andrew Caddie

### *Consumer Guarantees Act - Application to Valuers Services*

The Consumer Guarantees Act 1993 comes into force on 1 April 1994.

The Act is a significant re-write of existing legislation relating to the supply of goods to consumers. The Act also breaks new ground in that it extends to the supply of services.

The Act sets out a statutory regime as to the minimum guarantees that will apply on the supply of goods or services to consumers. The Act gives consumers a whole raft of remedies against suppliers whose goods or services breach the statutory guarantees. This article focuses on that part of the Act dealing with services and the impact the Act will have on valuers.

### *Coverage of the Act*

The definition of services in the Act is very wide. The Act defines a service as meaning any right, benefit, privilege or facility granted by a "supplier" pursuant to certain types of contracts. The Act specifically includes professional services.

A supplier includes a person who, in trade, supplies services to a "consumer".

The definition of consumer does not focus on the purchaser or receiver of the services. Rather, it is a two stage test based firstly on an examination of the type or kind of services supplied, i.e., are the services of a kind ordinarily acquired for personal, domestic or household use or consumption? If yes, then secondly, is the person acquiring the services doing so for the purposes of re-supply in trade or for further processing? If not, then the person is a consumer. Under the Act a consumer can be a natural person or an incorporated or unincorporated body (including local authorities and public bodies).

The ordinary use test is likely to throw up many anomalies until its parameters are established by the Courts. For example, in broad terms, valuers supply services both to consumers (as defined) and also to non-consumers. Quite clearly the valuation of an individual's house for sale or insurance purposes is the supply of a service of a kind ordinarily acquired for personal use. What is the position if a person or organisation requests the valuation of a building which the person or organisation wishes to purchase for investment purposes?

Will the Courts in considering the first arm of the consumer definition look at a broad definition of valuation services or will they look at the particular valuation service?

Arguably, under a broad definition, as some valuation services are ordinarily acquired for personal use then (so the argument might run) all valuation services satisfy the first arm of the test.

Under the specific service approach, the service is better defined as the supply of valuation services to investors. It is then possible to argue with some conviction that investment valuation services are services not ordinarily acquired for personal use.

However, if we are wrong about this, is the second limb of the consumer definition satisfied? That is, is the person acquiring the services, acquiring them for the purpose of re-supplying them in trade? If the person requesting the services is a real estate agent who wishes to place the product of the service (valuation) in a presentation brochure then, in our view, the real estate agent is re-supplying the services in trade. There is no supply to a consumer. However, if the acquirer of the services intends to use the product of the services in a manner merely incidental to its core business activities then the second limb of the "consumer" test is satisfied. The service is being supplied to a consumer.

*Michael Burrowes*

The sorts of anomalies we have outlined above will be clarified by the Courts in due course. However, it is important to grasp that in many instances a business entity may acquire valuation services for incidental business purposes but still be classified as a consumer in terms of the Act. Accordingly, the contracting out provisions of the Act, insofar as they relate to the supply of services to businesses, are of great importance to valuers if they wish to avoid the application of the Act to business transactions.

*Andrew Caddie*

### *What does the Act do?*

The Act lays down a set of guarantees or minimum standards which are to apply where services are supplied to consumers. These guarantees are:-

- the service will be carried out with reasonable care and skill;

- the service (and any product resulting from the service) will be reasonably fit for the particular purpose for which the service is required;
- the service will be of such a nature and quality that it can reasonably be expected to achieve the particular required result;
- the service will be completed in a reasonable time; and
- where the price has not been agreed in advance, the consumer is not liable to pay more than a reasonable price for the service.

## *Does the Act change anything for Valuers?*

The rules of the New Zealand Institute of Valuers provide for a Code of Ethics governing the professional conduct of members.

There are a number of references in the Code of Ethics as to the standards expected of a valuer's services.

A strong statement is contained in Clause 17A of the Code. This states that "a member should observe the highest standards of professional competency expected of a valuer having regard to the nature of the assignment being undertaken".

In our view the Act's guarantee as to "reasonable care and skill" arguably sets a lower standard than that contained in the Code.

Where the consumer makes known to the valuer the particular purpose and desired result from the engagement then the Act's guarantee as to fitness for a particular purpose will apply. Clause 3(iii) of the Code requires the valuer to "refuse to undertake any valuing work for which he or she is not qualified or there is any doubt as to the adequacy of his or her professional experience to undertake the work". In this area the requirements of the Act are not dissimilar to the Code.

However, like all suppliers of services, valuers will have to be more careful in advising consumers as to what is a realistic or reasonable result.

In our view, the guarantee as to completion of the service in a reasonable time is within the general spirit and intent of the Code if not the letter.

The guarantee as to price may prove to be contentious. The consumer's sole right of redress in respect of this guarantee is to refuse to pay more than a reasonable price. In many cases, valuation and other professional services are undertaken on the basis that a bill will be rendered when the services are completed. Unless the service provider has set a price or can point to a standard set of terms and conditions setting out his or her charging policy (thereby allowing the price to be determined or calculated pursuant to a "contract"), then there is scope for the consumer to argue there has been a breach of the statutory guarantee.

One can only wonder whether the Courts will take the view that a reasonable price for services supplied by a small provincial valuation practice may be somewhat different from a reasonable price for the same services supplied by a large city practice given their different circumstances and cost structures.

## *Consumer Remedies*

In respect of failure to comply with the guarantees (except the reasonable price guarantee), the consumer may require the supplier to remedy the failure within a reasonable time. If the supplier fails to do so, the consumer can have the failure remedied elsewhere (and recover all reasonable costs from the supplier) or cancel the contract. If the failure can't be remedied or it is of a "substantial character", the consumer may cancel the contract or seek damages for any loss in value of any product of the service.

In addition to these remedies the consumer can obtain damages from the supplier for any losses which were reasonably foreseeable as liable to result from the failure.

Where the consumer is a business, loss of profits or earnings may fall within the category of "reasonably foreseeable losses", unless exceptions in the Act apply or the supplier has contracted out of the Act.

## *Exceptions*

A consumer has no right of redress against a supplier in respect of a service where:

- the service is supplied otherwise than in trade e.g., free advice given at a social function.
- the service is supplied by a charity.
- in certain cases the failure was due only to:
  - (a) an act or omission by a person other than the supplier; or
  - (b) a cause independent of human control.

## *Contracting Out*

As discussed, the definition of service is such that in certain circumstances a supply of services to a business will be treated by the Act to be a supply to a consumer.

However, the Act permits contracting out in certain defined circumstances, i.e., where a consumer acquires services for the purposes of a business, and:-

- the parties have agreed, in writing, that the supply is for the purposes of a business, or;
- if this is not possible, the supplier has clearly displayed at its place of business that the Act will not apply to the supply of services to a consumer who intends to use them in a business.

Every supplier who tries to contract out of the Act other than as permitted by the Act commits an offence under section 13(i) of the Fair Trading Act 1986. On summary conviction this may result in a fine not exceeding $100,000 for a body corporate or $30,000 for a person.

It also needs to be borne in mind that the statutory guarantees, and the consequential remedies set out in the Act, are in addition to any other right or remedy under any other law.

## *What to do*

If not properly managed, the implications and ramifications of the Consumer Guarantees Act could have a significant adverse impact on the businesses of service providers, including valuers.

We recommend that you designate a person within your organisation to come to grips with the Consumer Guarantees Act and how it might impact on your practice or business.

That person should bring himself or herself up to speed with the Act and carry out a check of your business activities and identify possible problem areas. Recommendations flowing from such a check should then be implemented well in advance of 1 April 1994.

# Rent Reviews

## How Arbitrators Should View Evidence From Other Rent Reviews

by Quentin J Lowcay BCA, LLB

Times are still tough in the commercial property market. With the over-supply of leasable space and ratchet clauses still biting, there have not been the numbers of rent reviews and arbitrations as there used to be. However those that have occurred are no less hard fought, with legal issues continuing to arise.

Arbitrators have a difficult job in commercial rent reviews. Increasingly, arbitrators find themselves having to grapple with technical and legal arguments which were not anticipated when they accepted their appointments.

As most valuers are only too well aware, a rental arbitration invariably involves a battle between the valuers as to the in-depth market analysis of other rent settlements to be used as comparative evidence for the purposes of the current dispute.

Questions arise as to how this wealth of comparable information on market rentals for similar commercial properties should be received and assessed by the arbitrator.

### *(A) Nature of Evidence Required*

The usual starting point in terms of identifying the nature of evidence required to be submitted to the arbitrator is the Court of Appeal decision of *Modick R C Ltd v Mahoney'.*

The Court held that the appropriate test to apply to determine the new rental under the rent review clause in that case, was to ask what would be agreed between "reasonable parties". The Court elaborated this concept into being the "willing lessor/willing lessee" test to be applied in the context of the circumstances in which the lessor and the lessee find themselves.

The Court of Appeal held that the new rental should be a figure which:

> "... would notionally be agreed upon by the parties, acting freely and adequately informed. Figures fixed by arbitration or rent reviews as between captive parties are not necessarily a reliable guide, since they do not represent the unfettered play of market forces, but rather the arbitrator's assessment (assuming that he has applied himself to the task correctly) of what market forces should produce.
>
> It is only a freely negotiated rent review on a new letting that can confidently be taken as to be truly comparable, provided of course that there are also sufficient similarities in site and otherwise."

This means that rent reviews between current lessees and lessors are not truly indicative of market rentals. This is of course because a currently resident lessee often has little leverage over the lessor.

In fact, to complicate the level of analysis the valuer as arbitrator or expert must undertake, *Modick v Mahoney* held, that where there is an absence of truly comparable transactions the lessee is entitled to contend that "reasonable persons" in the parties' situation would take other factors into account. In *Modick v Mahoney,* "other factors" included the accounts of the lessee showing a financial loss relied upon to suggest a lesser rent.

Indeed it would seem to this writer that "reasonable persons" would take other factors into account even where there are truly comparable transactions.

The arbitrator is therefore faced with a difficult decision in relation to what evidence must be considered at all. If the arbitrator considers evidence which should not be taken into account, then the award may be able to be challenged. Similarly, if the arbitrator refuses to admit certain evidence which was admissible and relevant then the award is again open to challenge.

Some guidance can be drawn from the UK decision in *Ponsford v HMS Aerosols Lt&.* The House of Lords held that improvements made by the lessee should be taken into consideration when determining the "reasonable rental". However, there has been much criticism of the decision which can be seen to turn on the particular wording of that rent review clause'.

The issue of what evidence should be considered was partly addressed in *Modick v Mahoney.* Hardie Boys J held:

> "To adapt what Lord Salmon said in Ponsford the arbitrator cannot make his assessment in blinkers or in a vacuum. The profitability of a business for which the site is suitable and even more the profitability of a business of the only kind that is able to be carried on on the site may well have a bearing on the value of the property and rental to be obtained from it.
>
> The valuer or arbitrator is unlikely to be an accountant or an expert in business management, and so is likely to look to true, i.e. contemporary, market rentals of real comparability as a better guide than the lessee's own accounts, for they may reflect factors peculiar to the business rather than factors relevant to the rental value of the property. But in so far as they bear on the latter, they will be relevant."

This statement is helpful in that it explains the inclusion of accounts where they are linked to the site's value as a business asset. However, to some extent it begs the question as to what other factors are relevant.

[ 199211 NZLR 150

2[19791 AC 63

'The clause stated "a reasonable rental for the demised premises" - therefore clearly including improvements.

## (B) Quality of Evidence From Other Settlements

As stated above, comparable open market settlements between independent parties are the best source of evidence as to the appropriate rental. However, what if the parties to the other comparable transaction are unwilling to give necessary details to the arbitrator?

The recent (and much publicised) case of *Dickinson & Ors v Board of Trustees of the National Provident Fund'* reinforces the usefulness of the subpoena.

The Court of Appeal held that subpoenas could be served on the parties to a recent commercial rent review, and the parties had to give evidence of the terms of the relevant letting agreements and rentals. The subpoenas were issued in accordance with section 9 of the Arbitration Act 1908. This was in spite of a confidentiality clause in the other agreements.

The evidence which any valuer or arbitrator can gather (according to the *Handbook of Rent Reviews')*, in descending order of quality is:

1. Open market letting.
2. Agreement between valuers at arms length.
3. Determination by independent expert.
4. An arbitrator's award.
5. Determination by the Courts.

Even other rentals which may at first appear to be comparable need to be scrutinised to ensure that they are truly comparable. Considerations include:

(a) Use - Crucial to comparability is the relative use of the properties or restrictions placed on use.

(b) Lease clauses - These may affect rent reviews where differently worded clauses exist (e.g. review clause itself, alienation restrictions, redevelopment, insurance, repairs, liabilities, ratchet clause).

(c) Location - Real estate is heterogeneous. No two properties can be located in the same place. So subjective criteria must be taken into consideration when comparing separate sites (e.g. access, light etc).

(d) Time - Post-review rental changes are of little weight since they will incorporate other commercial pressures/ concessions.

(e) Size - Necessary adjustment must be made for varying sized properties, and any "bulk discount" available.

(f) Improvements - Whether material improvements have been made between rent reviews or by other parties in comparable properties.

*"The rent review clause is crucial to the analysis the arbitrator must undertake."*

It must be remembered that the particular wording of the rent review clause is crucial to the analysis the arbitrator must undertake.

The Court in *Dickinson* was ensuring that the umpire had before him evidence of rental levels arrived at freely in negotiations between arms length parties, in contrast with those arrived at in captive circumstances.

The Court held:

> "Such genuine market rentals are not always easy to discover, and when discovered they may be of great importance in assisting an umpire in carrying out his difficult task of assessment ... It is desirable that he should be able to get at the truth as to these allegedly comparable rentals.
>
> ... In my opinion, the overriding public interest is in as fair a fixation of the market rentals as possible. The upholding of the subpoenas will be conducive to that."

Therefore, direct evidence before another arbitrator or umpire will be available by subpoena.

## (C) Quality of Other Arbitration Awards

If a party, rather than issuing a subpoena on the parties to another settlement, merely produces an arbitrator's award, what is its status?

In the UK, the House of Lords has recently held firmly that an arbitrator's award determining the market rent of a property is inadmissible in evidence in another rent review arbitration of comparable property *(Land Securities plc v Westminster City Council)*.

This is a somewhat surprising result. The Court held that the arbitrator's award was merely an opinion of one expert. As such, it must be capable of cross-examination to be used as evidence before another arbitrator. An award (as a written document) fails this test.

But the House of Lords did hold that evidence of rents of comparable properties on the open market or in rent reviews was admissible.

In New Zealand *Modick v Mahoney* has held that arbitration awards are admissible - they are just not as significant in evidentiary value as open market transactions.

However, the decision in *Modick v Mahoney* was prior to the UK decision of *Land Securities* and it might be said that in New Zealand the Court of Appeal has not had to address specifically the issue of admissibility of arbitrators' awards. The House of Lords decision would be highly persuasive in New Zealand and it is possible that if the Court of Appeal was asked specifically to address the issue it might follow *Land Securities.* The issue is arguable. Valuers/arbitrators need to exercise caution because, in the light of the UK decision, they may expect to find parties to rent review arbitrations challenging the admissibility of awards in other cases. At the very least, the weight to be given to them is likely to come under even more scrutiny.

*"Valuers/arbitrators need to exercise caution because... they may expect to find parties to rent review arbitrations challenging the admissibility of awards in other cases."*

In the writer's view, the present situation in New Zealand of awards being admissible should continue. The arbitrator should have the evidence before him and it then becomes simply a matter of the weight to be given to it.

As Sir Duncan McMullin, acting as umpire in an earlier case, stated:

> "To refuse to accept evidence of arbitral awards would be to turn one's back on a source of information to which a prudent lessee might well have regard."'

On the other hand, the arbitrator who has issued the other award might have got it wrong and such other awards should not necessarily be relied on at all.

'Unreported, Court of Appeal, 24 September 1991, CA 268/91

'Bernstein, Reynolds, Rodger & Edgcumbe (Sweet & Maxwell, London, 1989) at para 8-51

6[ 1993]4 All ER 124

'*Wellington City Council v Harbour City Realties Ltd,* Arbitration 30 November, 1-4 December 1992, at page 5

# foRum

Compiled by Ian Mitchell

## Editorial

Welcome to Technology Forum. This editorial sets out the objectives of Technology Forum and how I envisage it will develop over the next four issues.

Technology Forum will be a regular feature in the New Zealand Valuers' Journal and will cover a wide range of issues. It will not be confined to computer based technology, rather the aim is to address a variety of technology related topics. Articles will cover areas including information systems and building technology, property sales database issues, telecommunication technology and computer hardware and software developments.

Identifying the technology issues of interest to Valuers is one of the principle challenges I face. To ensure that Technology Forum covers areas of your interest a questionnaire will be included in a subsequent issue of the New Zealand Valuers' Journal. The information you provide in responding to this questionnaire will enable me to determine the technology areas that interest different groups in the valuation profession and the results of the questionnaire will be published in a subsequent issue.

Another feature to be established is the Technology Forum Mail Bag. This section will provide an opportunity for those of you who wish to raise technology related issues or problems to write in and have your query answered by a panel of "experts". If you are having a technology related problem, you can feel confident that others within the valuation profession are likely to have similar concerns. It is hoped that "Mail Bag" will be one way you can raise technology related issues for appropriate discussion and comment. I will endeavour to send a direct written response to any queries. In addition to having your comment or query answered, it will by published (anonymously if preferred) in the Technology Forum Mail Bag, thus providing food for thought for others within the profession.

If you have particular skills in a technology related field I would be interested in hearing from you, especially if you are willing to become a member of the panel addressing the issues raised in Technology Forum Mail Bag. I can be contacted at Darroch & Co, PO Box 27-133, Wellington, or through the office of the NZIV Chief Executive Officer at PO Box 27-146, Wellington.

Ian Mitchell

## About the Author of an Introduction to Hardware Componentry

*James Bennett is a graduate of Massey University with a degree in Computer Science. After a few years dallying with biochemistry, James decided to pursue a computer based course as most of chemical analysis was being carried out by computers. On completion of his degree, James worked for an insurance broker doing financial modelling before taking a position as a Consultant with the Business Studies Faculty of Massey University. James now works for the University's Institute for Executive Development as the information Systems Consultant.*

## Introducing Ian Mitchell:

*Ian Mitchell has recently been appointed Head of Research with Darroch & Co. at Wellington. Prior to this he* was *a Lecturer in the Property Studies Department atMassey University from 1989 to 1993. Whilst at Massey Ian lectured in a range of areas including property management, valuation, property investment, and advanced research methods in property. He also completed a Diploma in Business Administration, and a Master of Business Studies in Property with Distinction. Whilst at Massey he presented a number of papers at overseas conferences and undertook consultancy.*

*Between 1986 and 1989 Ian travelled overseas in Europe, Africa and Australia. During this time he worked for a number of international financial institutions including Morgan Stanley International and Irving Trust, in varied financial analysis roles.*

*Ian Mitchell holds a Bachelor of Agricultural Science and a Post Graduate Diploma in Valuation from Massey University, and he worked for the Rural Bank in Napier as a registered valuer for four years. Ian says, in taking up subeditorship of Technology Forum for the New Zealand Valuers' Journal, "I am interested in the development and implementation of technology within the valuation profession. Technology is part of our lives as we move into the twenty-first century and beyond, and I believe it offers Valuers ways to increase efficiency and productivity."*

# An IntroductionTo Hardware Componentry

by J Bennett

I assume most of you are familiar with personal computers (PC's) if not at home then definitely in the work place. Although we use PC's regularly, it is often a mystery as to what actually makes the computer work; how the various components affect the computer's performance and whether an upgrade of some of these components is a worthwhile solution.

People's attitudes to computers generally fall into three categories and these are enthusiastic, indifferent or apprehensive. Computer enthusiasts, who usually tread a fine line between being regarded as normal people or computer nerds, are quickly relegated to the latter when they start talking in acronyms and computing jargon. For example; "my scuzzi controller has an incompatible DMA method so I am using double buffering for the virtual memory swap file". This is rather dry small-talk and does nothing to endear computing and its associated technology to normal people. But for all that, knowing a little about your computer can remove some of the fear of technology and you need not feel like an ignoramus when dealing with computing people.

The aim of this article is to introduce and explain the component parts of your computer. The areas covered are hardware, monitor, video cards, base and central processing units, disk and input/output controllers, memory, and floppy disks. Two common computer terms are hardware and software. Software refers to the programs, such as spreadsheeting, database and word processing packages, that you run on your computer. Hardware is the physical components of the computer.

## Hardware

The physical components of your computer bits you can see and touch are called hardware. If you look at your computer now, you can easily identify 3 major components.

(1) the monitor or screen

(2) the base unit or main case

(3) your keyboard (and mouse)

On laptops and portables these items are all integrated into a small compact case. Most desktop computers have separate components. Let's have a look at these *hardware* items a little more closely.

### Monitor

The monitor is sometimes referred to as the visual display unit (VDU) or cathode ray tube (CRT). This is essentially a small high-resolution TV. The inside face of the monitor is covered in hundreds of thousands of tiny phosphorescent dots. These dots glow when excited by electrons which are zapped out across the screen in a fine beam one row at a time. Monochrome screens have one electron beam and single phosphors but most colour monitors use three electron guns and coloured phosphors arranged in triads. One electron gun is aimed at each colour. The dots only glow briefly before fading to black again. On older monochrome monitors the dots glow long after the electron beam ceases to emit. Changing a screen image (scrolling through a document for example) would leave a ghost of the previous image on-screen. Modern, high-resolution colour monitors use phosphors with a short persistence which allow faster image changes and eliminate ghosts.

The monitor has developed considerably over the last 10 years. From humble beginnings as an eerie glowing green screen, it moved to the amber monochrome screen and then to the 4-colour CGA. From there the monitor has progressed to the 16-colour EGA then to the 256-colour VGA and the 32000 and 16 million-colour SVGA's are now the industry standard. Your monitor should fall into one of the following categories:

CGA Colour Graphics Array mono or 4 colours

EGA Extended Colour Graphics Array mono, 4 or 16 colours

VGA Video Graphics Array 16 or 256 colours

SVGA Super VGA 16, 256, 32000 or 16,000,000 colours

The monitor receives information from a special piece of equipment inside the base unit called the *video adaptor* or *video card.* The video adaptor and your software determine the effectiveness of the picture on the screen.

### Resolution

This refers to how many dots are used to draw a screen of information. In text mode (as most DOS applications are) the screen only displays 80 characters across by 25 high. The characters that can be drawn on the screen are quite limited and are defined by the character set used; usually ASCII or ANSI. Graphics modes are not limited to predefined character sets and programs can manipulate the screen to produce a variety of images. Graphics drawn this way may be a variation of a text character such as *italic* or bold, or a picture such as a pie graph or half-tone photograph. The resolution of the screen is determined by the software you are running, the capabilities of the video card, and to a lesser extent, your monitor.

Table 1 presents some examples of video modes you may have seen and the resolution they run at.

There are some limiting factors to consider when selecting the video mode. First, the greater the number of colours you wish to use the more video memory you need. To run a SVGA at 1024 by 768 with 256 colours you will need 1 MB (mega byte) of video RAM (random access memory). If you only have 512 KB (kilo bytes) then you will be limited to 16 colours at that resolution. Second, the higher the resolution you specify, the slower the response rate and text on screen can become uncomfortably small. You may also have a monitor which is not fast enough to accept data at the speed the video card can provide so it compromises by *interlacing* the image.

You will usually only need to know about video modes if you are running Microsoft Windows NT or OS/2. DOS applications not requiring graphic displays can get by with minimum hardware.

Most monitors nowadays are colour and usually 14" (inches) on the diagonal. If you will be doing a lot of page layout work or graphics production it pays to get a monitor bigger than this - say 15 or 17 inches and run it at a higher resolution.

Table 1: Video Modes and Resolution

| Mode | Resolution (Dots across by dots high) |
|---|---|
| CGA | 320 by 200 or 640 by 200 |
| Mono | 720 by 350 |
| EGA | 640 by 200 or 640 by 350 |
| VGA | 640 by 480 |
| SVGA | 800 by 600 or 1024 by 768 or 1280 by 1024 |

Interlacing

This term is often bandied about when referring to monitors and SVGA mode. In interlaced mode, the monitor draws the picture by zapping an electron beam back and forth across the screen but only draws every second line. When it gets to the bottom it goes back to the top and draws the odd numbered lines so the picture appears to flicker slightly. Good high refresh rate monitors will draw the whole screen in one pass. This is a lot more work for the video card which must be designed specially for this mode.

Base Unit

The base unit is the metal case within which the actual computer is contained. If you monitor sits on top of the case you have what is called a desktop case. If the case stands on its side on the floor or desk it is called a tower case.

Big tower cases have more room for extra disk drives and adaptor cards. It may surprise most people to know that there is a very large amount of nothing inside your computer's case. If you have ever opened one up, you will know that there is not much inside the case and this explains how all that technology can be fitted into a small A4 sized Notebook computer.

Items typically found within a computer case are listed below. Those marked with an asterisk must be within the case.

- Power supply*
- Hard drive
- Floppy drive
- CD-ROM drive
- Mother board*
- Video Adaptor
- 1/0 card or disk controller*
- Network Adaptor
- Modem
- Sound card

The main item in the base unit is the mother board. This is quite an endearing term for such a sterile, hi-tech circuit board. It is really the host board and any additional functions required can be attached to it. This board is covered in small electronic gadgets, resistors, blobs of solder and the ubiquitous *chips.* As component technology has become more advanced, what used to take up the space of a small circuit board has been reduced on to a chip and these chips sit on the mother board.

The mother board holds the Central Processing Unit (CPU) and memory as well as a large number of ancillary functional components. The CPU is the *brains* of the PC and carries out calculations and commands. Consequently, it plays a large role in determining the overall performance of your computer. There are a large number of CPU's used in PC's but if you have an IBM compatible type machine, it is likely to contain one of the CPU's listed in Table 2.

Table 2 presents chip speeds in ascending order of speed. The Pentium is the fastest chip available in this series. The higher the speed of the chip, the faster it processes information.

The design of 80486 and 80386 chips is very similar. However, 80486 chips also have a built in co-processor. This assists with intensive maths calculations, advanced drawing programs, and some specialised engineering programs. In the 80486sx versions the co-processor is disabled or not present and consequently, these versions are cheaper. The 80386sx and 80386dx CPU's are essentially the same, however the 80386sx communicates with other devices at a slower speed.

The mother board and its CPU does not yet do all the jobs your computer is required to do. Tasks such as preparing graphics in a form suitable for your monitor are handled by a dedicated circuit board called the video adaptor. This card has its own memory and instruction sets, and varies enormously from machine to machine. Input/Output from other devices such as keyboard, mouse, printer, modem, joystick and disk drives is handled by another card called the 1/0 controller.

Table 2:Common Chip Names and Speeds

| Chip Number/Name | Available Speeds (Mhz) |
|---|---|
| 8088 (PC) | 4.8 |
| 8086 (XT) | 4.8 |
| 80286 (AT) | 4.8, 8, 12 |
| 80386 sx | 12, 16,20,25,33 |
| 80386 dx | 20,25,33,40 |
| 80486 sx | 25,33,40 |
| 80486 dx | 25,33,50 |
| 80486 dx/2 | 55,66 |
| 80486 dx/3 | 100 |
| Pentium (80586) | 60,66,75 |

Video Cards or Adaptors

Video cards or adaptors, plug into the mother board. They also have a socket into which the monitor cable plugs. The socket appears on the back of the PC where all the other cables attach. These cards fall into two basic categories. On older machines, the socket for the monitor has only 9 holes. Newer machines have sockets for 15-pin connectors. If your machine has 9 pins then the video unit is most likely a CGA, EGA or Hercules MONO. If it has 15 pins, your video unit is most likely to be a VGA, SVGA or XGA.

The Video card also has its own memory and sometimes has additional hardware to help speed up graphics handling. This reduces the work of the CPU and allows the CPU to do other jobs which increases the apparent speed of the system. If you are running Microsoft Windows and variants you will know that it is a lot slower than ordinary text mode. A MONO text mode screen is 80 x 25 characters = 2 KB. A Windows screen of information is all graphics and may be up to 1 MB which is a lot more work for the CPU to do, which results in a slower system. One way to speed up a computer is to upgrade to a faster CPU if you want to run MS Windows. Another is to change the video card to one with an accelerator or a local bus. Local bus is sometimes called VESA. Local bus needs a special slot on the mother board called a local bus slot. Most suppliers have these mother boards as standard or as an option and to purchase a mother board with this option is not substantially more expensive. The VESA local bus version has a direct connection to the CPU and runs at the same speed. It is not shackled by the bottle-neck that the ordinary ISA video cards have to work through. The ISA bus is the old industry standard for mother boards and is very slow. Other "bus" terms you may have encountered are MCA (IBM's micro channel architecture), EISA (extended industry standard) and PCI (peripheral component interconnect). Basically, the new versions offer higher data transfer between the CPU and other devices, of which the video card is one. If the CPU can get the information to the video card faster, the whole system appears to run faster.

I/O Controller and Disk

1/0 is an abbreviation for input/output. The 1/0 card is a small circuit board which allows the CPU to read and write to the disk drives and usually provides ports (outlets) for connecting printers, mouse, joystick, modems etc. It is sometimes called the 1/0 controller because it controls devices that provide *input* to the CPU and can accept *output* from it. The outlet from this card appears on the back of the PC. Yours may have cables plugged into some of these. These are called the serial, parallel and games ports. Serial ports can be of two different sizes, 9-pin and 25-pin plugs, and there is normally one of each. To these you can connect a mouse, a modem and sometimes a printer.

Parallel ports are always 25-pin sockets and it is more than likely that you will have your local printer connected to it. They are called parallel because of the way in which data is transmitted. On a serial cable, each bit (part of a byte) is sent one after the other whereas on a parallel cable all the bits go at once. The games port is a 15-pin socket to which you can plug in a joystick, or steering wheel for some games.

The hard disk is the main storage device on most PC's. Early computers had 10, 20 and 40 megabyte (MB) drives. Modem machines will have 85, 120, 170 or 240 MB drives. Larger drives are being developed and these can range from 512, 1200, 1690, 2100 and 2900 MB. These size drives seem excessive now but with the current trend to large, bloated, graphical software packages that consume vast amounts of storage, large drives are a necessity. New operating systems may use 30-100 MB, with applications (your programs) using 15-50 MB each. Graphics files may be 1-10 MB each. Fifty of these would put a dent in your storage.

The hard disk, as its name suggests is a *hard* version of *the floppy* disk. Hard disks are made of metal or glass covered in a magnetic media similar to that on audio or video tapes. But the hard disk unit has more than one disk inside it. Usually there are two or more disks of which both sides are used. The disks spin around like a record but go considerably faster at around 3600 rpm or more. This is about 10-times faster than your floppy disk drive.

Information is stored on the disk in little tracks which are divided into sectors. There are 80 tracks on the high-density lfoppy disks but a typical hard drive will have at least 10 times as many tracks per disk. Hard disks come as sealed units to prevent entry of dust, smoke and moisture. Because the disk spins so fast and the read/write head is so close to the surface, any small particles that may get between the two can cause damage to the disk surface and the read/write head. In the old days this was called a head crash or hard-disk crash. These are very infrequent on modern hard drives which usually come with a three or five-year warranty. Some of the new server drives can have 10-year warranty.

To read or write information on the disk, a small *head* moves in and out across the disk surface. As the magnetic material on the disk whizzes past it induces a small electric current in the head which is interpreted as series of ones or zeros - the basic form of data storage.

## Memory

Unfortunately this term provokes analogies with human memory with all its rich complexities. Computer memory is extremely simple. Information is either there or it isn't - none of this "I can't quite remember" stuff. Also the location of information in a computer's memory is always known whereas humans can forget things and recall later (usually when it is too late). Memory in a computer is usually called RAM (Random Access Memory). Random access means that any location in memory can be accessed in the same time as any other location could be. Conversely, to find something at the end of a tape, (such as a video tape) you need to sort through all the information contained on the tape from the start. This is called sequential access.

Disk drives and CD-Roms are also Random Access types of storage. Memory comes in the form of small *Chips.* These are inserted as required onto the mother board in special sockets. The more memory you need, the more chips you get. Memory chips also come in different sizes (256 KB, I MB, 4 MB and 16 MB) and generally cost about $90 per MB although prices vary considerably.

## Storage units

Computers store data as bits and bytes. A byte is usually one character. Therefore I KB (kilobyte) is 1000 characters, 1 MB (megabyte) is 1,000,000 characters and 1 GB (gigabyte) is 1,000,000,000 (billion) characters.

A high-density 3'/z" floppy disk holds 1.44 MB which is 1,440,000 characters. To give you an idea of how much printed paper this equates to, consider an A4 page. With margins, you can fit about 60 characters per line and 55 lines per page. If every space was used, this would be about 3,300 characters per page. So a 1.44 MB disk would hold about 436 pages of text. Generally, this varies depending on the word processing package you use and whether or not there are graphic items included. Graphics use much more room than text. If this page was scanned and converted to a graphic it would occupy anywhere from 500KB - 5MB depending on resolution and file compression. However, the same information can be saved in text mode and this uses considerably less storage space.

## Floppy Disks

These come in a large variety of sizes. Table 3 presents the common floppy disk drives available.

Newer disk drives can read disks prepared or formatted in older disk drives. However, older lower capacity drives usually have problems reading higher capacity disks. All 3'h" disks have a write/protect tab which you can open or close. Open means the disk is read-only and the computer cannot write to or delete files on the disk. Closed is the usual mode. Double-sided, high density disks have another hole opposite this which tells the computer whether the disk in the drive is double-sided, high density (1.44 MB), or double-sided, double density (720 KB).

Table 3: Common Floppy Disk Types

| Capacity (MB) | Density | Size |
|---|---|---|
| 0.180 | Double Sided Single Density | 5'/a" |
| 0.360 | Double Sided Double Density | 5'/4" |
| 0.720 | Double Sided Double Density | 3'/2" |
| 1.200 | Double Sided High Density | 5'/a" |
| 1.440 | Double Sided High Density | *3'h"* |
| 2.880 | Double Sided Quad Density | 3'/z" |

# Legal Decisions

*Reinstatement valuation - Valuation of three storey building for replacement insurance - Building burned down - Insufficient insurance moneys - Whether valuer negligently underestimated reinstatement value - Whether valuer duly exercised duty of care in respect of reinstatement valuation and lift requirement - Disabled Persons Welfare Act 1975, s25.*

In The High Court Of New Zealand
Napier Registry

CP114/91

Between Coleraine Holdings Limited (formerly known as Napier City Gym Limited

Plaintiff

And Harvey Fulton & Long

Defendant

Hearing 19-21 May 1993

Counsel: M.A. Courtney with J.G. Krebs for Plaintiff

Mrs P.J. Andrews with A.M. Stevens for Defendant

Judgment: 31 May 1993

## Judgment Of Ellis J.

The plaintiff took out replacement insurance for its three storey building in Napier on 20 December 1989. Its broker obtained a valuation for this purpose from Mr O'Dwyer of the defendant firm. He was an experienced public valuer. The building burned down on 1 April 1990. The insurance monies were insufficient to reinstate the building. The plaintiff blames Mr O'Dwyer and alleges he negligently underestimated the reinstatement value. The plaintiff claims to recover its losses.

## The Relevant History

Mr O'Dwyer's valuation certificate was sought with urgency. Mr O'Dwyer had already valued the property for other purposes. His certificate was provided to cover an insurance period of 17 months from 20 December 1989 to 31 May 1991 and stated:

" B. Reinstatement Estimate

The estimated cost of rebuilding the property at the level of costs applying at the inception of the current period of insurance ignoring the inflationary factors which may operate subsequent thereto including the use of currently equivalent building materials & techniques & such additional costs as necessary to comply with any Act of Parliament or any Regulation under or framed in pursuance of any such Act or with By-Laws of any Municipal or Local Authority (inclusive of all fees) ........................................... $488,200

Note (i) If the reinstatement estimate is based upon the use of different materials and/or additional services from those existing, briefly describe them ..................

Note (ii) By what amounts do the considerations referred to in Note (i) increase the Reinstatement Cost?......$

Note (iii) Are there any Regulations preventing reinstatement wholly or in part? If so give brief details........................

C. Demolition

What is the estimated amount required to cover the cost of any Demolition Shoring up or Propping of the building damaged or destroyed and the Removal of Debris including Contents whether damaged or not. $29,100

D. Inflationary Provision

(i) Indemnity (as defined in A above)

The estimated amount of inflation in "Indemnity Value" anticipated during the period of insurance only is.... $31,600

(ii) Reinstatement (as defined in B above)

The estimated amount of inflation in costs anticipated during both the period of insurance and the estimated reinstatement period taking into consideration time required for damage inspections, demolition, preparation of new preliminary proposals and their approval, preparation of work drawings and specifications, schedule of quantities, obtaining City Council approval tenders etc.

is ...................................... $97.900

Estimates under B, C and D are given without prejudice and all items including A are on the basis that this is not a structural survey."

The critical figure is the reinstatement estimate of $488,200.

The building comprised two discreet and uninterconnected parts. The property had frontages to Tennyson and Carlyle Streets. Principal entry was from Carlyle Street and provided for eleven carparks with level or near level entry to the ground lfoor which was untenanted. The ground lfoor comprised 490m2 and included a carpeted office and ablution facilities. This area had no internal connecting stairway with the upper floors. However it seems that some time before there had been internal stairs which had been removed and the gap in the dividing floor covered over but not in such a way as to create a separate fire compartment. Access to the first and second floor was from the carpark by external staircase to the first floor, thence by internal staircase to the third or mezzanine floor. The two upper floors had secondary access from Tennyson Street with which the first floor was roughly level. The first floor was of 504m2 and the mezzanine of 247m2. These were occupied by the plaintiff and recently set up as a gymnasium at considerable expense and effort. Its improvements included saunas, mirrors, and glued carpet floor covering. The mezzanine lfoor was of timber construction with a rimu floor. The first floor was also surfaced with rimu.

As it has turned out, the building could not be exactly duplicated because the applicable standards required the mezzanine floor to be concrete and this would involve strengthening its supports. Further the plaintiffs advisers thought a lift was necessary. As there were insufficient funds from the insurance to meet these extra costs, the plaintiff built a two storey building comprising a ground floor and a mezzanine totalling 1010m2. This building effectively replaced the top two floors of the old building with an extra 273m2. (The old building had a total area on three lfoors of 1242m2).

The expert valuers called by the parties reached a substantial degree of agreement. However the assessment of the "reinstatement estimate" could not be agreed. Mr Plested estimated $636,200 and Mr Simkin $566,400. Each selected the appropriate building "modal" and applied multipliers he considered appropriate to calculate the cost of replacing each floor separately. Mr Simkin however separately calculated the cost of the basic structure and the cost of furbishing. The selecting of multiples is a matter of judgment. The only true measure would be the actual cost. The assistance of a quantity surveyor operating on actual plans could be a useful and more accurate guide. Mr Eddy gave evidence as a quantity surveyor. However he had surveyed the original plans and the plans of the plaintiff's upgrading and modification. He added to these the requirements that the mezzanine floor had to be concrete, and that a lift was needed. The parties agree that the cost of a lift was $100,000 as at September 1990 when it would have been installed. Mr Eddy included $9,000 for glued carpets, and calculated rimu flooring to cover 742m2 would cost $53,205 (or at least this can be calculated from his figures). So his comparative figure would be (albeit nine months later) $741,300. It was suggested the figure in December 1989 would be $703,000.

Mr O'Dwyer, supported by his former partner Mr Harvey, maintained that his estimate was a careful and accurate one employing the same techniques. As to the requirement of a lift, Mr O'Dwyer knew of the code and enquired of Mr Redman, an architectural draughtsman of considerable experience, whether a lift would be required. Mr Redman said he considered the code requirements NZ Standard 4125:1985 with which he was already familiar. He said he telephoned Mr Hales, the Napier City Engineer, and he confirmed that no lift would be required. While Mr Hales had no memory of this telephone conversation, he confirmed his view was then that no lift would have been required.

As to the requirement that the mezzanine lfoor be concrete, Mr O'Dwyer stated that he had proceeded on the basis of a wooden replacement but made a generous allowance in selecting his multiplier which would have covered the cost of a concrete floor with a particle board floor laid on top.

Some argument was addressed as to the replacement value of the improvements affected by the plaintiff when it set up the top two stories as a gymnasium. Mr Hilterscheid said it cost about $150,000 and that was conservative as his own labour was included at only $10 per hour. Mr Eddy preferred to allow a round $100,000 on top of interior finishings which he allowed for separately. Mr Plested included it in fixing his multiplier for each floor. Mr Simkin used a separate multiplier for each floor. Mr O'Dwyer was well aware of the improvements from his previous inspections and he too included them in his valuation.

## The Lift

The plaintiffs argument is that a lift is necessary to comply with the Disabled Persons Community Welfare Act 1975. Section 25 required that in new buildings to which the public are to be admitted, or major reconstruction of existing ones; the:

> " means of access both to and within the building or premises, and in the parking facilities and sanitary conveniences to be available (if any), ensure that reasonable and adequate provision is made for disabled persons who may be expected to visit or work in the building or premises to enter and carry out normal activities and processes therein".

Section 25 further declared that NZ Standard Specification 4121 should be deemed a reasonable and adequate provision in terms of the requirement. The obligation to provide such is on the owner and the local authority.

> The appropriate parts of NZSS 4121 are:
>
> "Lifts
>
> 304.1
>
> Lifts complying with section 209 shall be installed provided that in the case of a two-storey building where the gross lfoor area of the upper floor is less than 400 metes squared, or a three-storey building where the gross aggregate floor area of the upper floors is less than 500 metres squared, a lift need not be provided if the ground lfoor complies with the requirements of this Standard and the upper floors have access for the ambulant disabled".

The argument proceeds on whether the ground floor and the upper two are to be considered separately because they in fact were separate units with no internal connection. Each could have its own level access from the street, the ground floor to the carpark and Carlyle Street and the first lfoor to Tennyson Street. The mezzanine lfoor would have a gross floor area of less than 400 m2 and would have access for the ambulant disabled. The building would, it was submitted for the defendants, thus plainly comply with the spirit of the specification and so the Act. The specification is not absolute in its application in any event. For these reasons I have no difficulty in understanding Mr Hales' opinion that a lift was not necessary.

However the plaintiff's evidence was that its experts had consulted City officials and concluded when setting about rebuilding, that a lift was necessary. At best the evidence was hearsay and I am satisfied that up to the day of giving evidence Mr Hales always thought a lift was not necessary and so would not have said it was. However when it was put to him that the spirit of the Act and Standard Specification was that the disabled should not be disadvantaged in the matter of access, he had to concede that a disabled person parking in the carpark would have to travel some distance by footpath to reach a level access off Tennyson Street. On this basis he was inclined to agree that a lift would have been required.

My reading of s25 as then enacted, is not to impose standards creating complete equality of access for the disabled: the mezzanine exception is an example. 'Be wording is flexible requiring " reasonable and adequate" provision. Further, NZSS 4121 is not an absolute requirement. I understand that in cases of doubt, the matter may be referred to the Director-General of Social Welfare for dispensation. I was not referred to any statutory or regulatory authority for that.

In my view a valuer in Mr O'Dwyer's position, asked for an urgent estimate, and knowing of the possibility that a lift would be required should have looked at the Standard and the Act and if in doubt enquired of Mr Hales. He was told of Mr Hales' opinion and relied on Mr Redman's knowledge of the Standard Specification. It would have been wise for Mr O'Dwyer to have stated that he was concerned to know whether a lift would have been required and relied on Mr Hales' opinion that it was not. I think if he had done so the plaintiff and its broker would have relied on Mr Hales' opinion too and so would not have enquired further. Again in hindsight the requirement of a lift is not a straightforward one. It may be that on a proper construction of the Act and Standard Specification, and a consideration of any flexibility and dispensation that may be possible, the conclusion would be that a lift is not required.

However, applying the standard of care I will shortly discuss, I consider a prudent valuer placed in Mr O'Dwyer's position, knowing what he did, should have alerted the Plaintiff to the possibility that a lift may be required, and leave it to his client to take the matter further if it wished.

The Duty of Care

I accept that Mr O'Dwyer's obligations can be expressed in his own words:

> "In conducting a reinstatement valuation, the task is to ascertain and define how much it would cost to replace the existing premises with a building which is of the same, or if that is not possible, similar, construction, has a similar standard of appointment, and which will comply with present day building codes imposed either by Parliament or by local bodies. If the existing building complies with the building codes then the reinstatement valuation relates to an exact replacement of the existing building. If the building does not comply then the reinstatement estimate must take into account the additional cost of rebuilding in accordance with the codes, but must otherwise reflect the cost of simply replacing the existing building. Such an approach has nothing to do with the market value or utility of the property, or the rental which such a property might obtain. It is an estimate of the current in-place cost of replacement. Depreciation is not relevant and is only taken into account with respect to the indemnity value as opposed to the reinstatement estimate."

He is only required to make an estimate, but in doing so he must exercise reasonable care and skill. In a situation such as this I accept the evidence that the estimate should tend to be at a higher rather than a conservative figure, as future costs are subject to influences that cannot be predicted with certainty and it is common experience that things, and buildings, seem always to cost more than one expects. Anyone who has built a house knows that. In recent years inflation has been a prime cause of such uncertainty and it is expressly allowed for separately in the certificate.

On the other hand, the estimate is constrained by the terms of the certificate and is not expressed to make allowance for contingencies and risks. While to overinsure may be desirable in one sense, it increases the premium. The insurance broker and client should turn their minds to that after receiving the valuer's estimate.

Further I accept, as correctly setting out the test the passage from the judgment of Watkins J. in *Singer & Friedlander Ltd v. John D Wood & Co* (1977) 243 EG 569 at page 574:

> "The valuation of land by trained, competent and careful professional men is a task which rarely, if ever, admits of precise conclusion. Often beyond certain well-founded facts so many imponderables confront the valuer that he is obliged to proceed on the basis of assumptions. Therefore, he cannot be faulted for achieving a result which does not admit of some degree of error. Thus, two able and experienced men, each confronted with the same task, might come to different conclusions without any one being justified in saying that either of them has lacked competence and reasonable care, still less integrity, in doing his work. The permissible margin of error is said by Mr Dean, and agreed by Mr Ross, to be generally 10 per cent either side of a figure which can be said to be the right figure, ie so I am informed, not a figure which later, with hindsight, proves to be right but which at the time of valuation is the figure which a competent, careful and experienced valuer arrives at after making all the necessary inquiries and paying proper regard to the then state of the market. In exceptional circumstances the permissible margin, they say, could be extended to about 15 per cent, or a little more, either way. Any valuation falling outside what I shall call the `bracket' brings into question the competence of the valuer and the sort of care he gave to the task of valuation."

Statements of principle to the same effect were referred to by counsel: Professional Negligence (Dugdale and others 1992) para 17.44, and Jackson & Powell on Professional Negligence 3rd ed (1992) pp218, 219.

The comparable estimates given in evidence are therefore:

| | |
|---|---|
| Mr O'Dwyer | \$488,200 |
| Mr Simkin | \$566,400 |
| Mr Plested | \$636,200 |
| Mr Eddy | \$703,000 |

Each of the three valuers used the same building modal (the cost of a basic house expressed as a cost per m2). Each then assessed the appropriate multiplier for his purpose.

Plainly the use of multiples of the building modal involves a subjective element and produces widely differing results. For example there is \$148,000 between the O'Dwyer and Plested valuations or 23%. This must cast real doubt on the reliability of the technique. After hearing all the evidence I am satisfied that for the purpose of an estimate of reinstatement Mr O'Dwyer should have arrived at a figure of at least \$80,000 more than he did, namely a figure in the order of that arrived at by Mr Simkin. I would have no criticism of Mr Plested's figure because I think it is wise and acceptable to make a generous estimate. I bear in mind that Mr O'Dwyer was asked for urgency, but he did know the building, and the standard and extent of the recent new work. He was criticised in some detail on such matters as the mezzanine floor saunas and mirrors, carpets, and rimu flooring. His valuation is explained by his choice of multipliers. These were too low and in my view his choice fell below the standard of care required of a professional valuer. He would have met that standard if he had estimated a figure \$80,000 higher or more. Mr Simkin, the valuer called for the defence, agreed that to value below his own estimate would be risky.

I should make a further reference to Mr Eddy's survey. He was considering old plans and not modern ones. The evidence indicates that more modem building techniques would be cheaper. I think his figures confirm Mr Plested's assessment, which I would hold to be an acceptable estimate. However, I am to decide upon the lowest figure that Mr O'Dwyer could fix exercising a reasonable standard of care and judgment. Put another way, if a median is taken between Mr Simkin and Mr Plested, a figure of \$601,300 is derived and the two figures differ from this by plus or minus 5.8%, which is an acceptable variation. Mr Simkin's value is nearly 11% less than Mr Plested's and I was told a variation of 5 to 10% was agreed by valuers as acceptable. This confirms my conclusion that Mr Simkin and Mr Plested are at the lower and upper end of an acceptable variation in valuation. The test of care is not to require Mr O'Dwyer to value at the middle of the range, but to bring himself within the acceptable range of valuation.

For completeness I refer to the inclusion by Mr Plested and Mr Eddy of a sum to cover a rimu floor, whereas Mr Simkin allowed for chipboard. As to the rimu lfoor, the evidence was that it was unobtainable and that chipboard was appropriate to the plaintiff's use. I consider that some flexibility of approach is realistic. I have borne this in mind and the controversial items of glued carpet and standard of fit out in arriving at my conclusion of an overall discrepancy of $80,000.

## Conclusion

I conclude therefore that a prudent valuer in Mr O'Dwyer's position should have drawn attention to the possibility of a lift being required and that he had not included it, relying on Mr Hales' advice. Further he should have estimated the cost of replacement at not less than $568,200. I further conclude that on balance if Mr O'Dwyer had drawn attention to the lift, it is likely that the plaintiff and its broker would have relied on Mr Hales too and not increased the cover. As a result the plaintiff has succeeded in establishing a negligent underestimate which I have quantified.

## The Loss

By consent the quantification of this is adjourned for further evidence and consideration. The parties are agreed on certain aspects of valuation which I need not record. The measure of damages will be that required to put the plaintiff in the position it would have been in had the estimate been $568,200. If the matter cannot be settled, the hearing should resume. The plaintiff is entitled to costs and the quantum of these is reserved.

## Solicitors:

Langley Twigg, Napier

Kensington Swan, Wellington

*Diminution in value of property - Subdivision pursuant to will - Will required registration of restrictive covenant concerning building to limit derogation of views Unit plan registered - Appellant's view partially obstructed by respondents' house Building complied with will though not with height limits under unit plan - Whether air space was common property - Whether the Appellant was under a fiduciary obligation to the respondents - Indefeasibility of Appellant's title - Unit Titles Act 1972, ss 2-6, 8, 9, 12-14, 37, 44.*

<u>In The Court Of Appeal Of New Zealand</u>

<u>CA 3/91</u>

<u>Between Pamela Jessie Disher</u>

<u>Appellant</u>

And <u>Prudence Ann Farnworth</u> and <u>Jane Patience Godfrey</u>

<u>Respondents</u>

<u>Coram</u>: McKay J

Robertson J

Sir Gordon Bisson

<u>Hearing</u>: 30 June and 1 July 1993

<u>Counsel</u>: B E Page for Appellant

L H Chisholm and Jane A Howden for Respondent Mrs Farnworth

<u>Judgement:</u> 12 July 1993

## Judgment Of The Court Delivered By McKay J

Mrs Disher is the owner of a stratum estate in fee simple under the Unit Titles Act 1972 in two units which are designated A and C on the unit plan, unit A having a frontage to Oceanview Road, Mt Maunganui. The respondents, Mrs Farnworth and Mrs Godfrey, are the owners of the remaining unit B. The three units are contiguous in line, unit C being in the middle. Mrs Disher lives in a house on unit A from which the land slopes down to the adjoining unit C, which is vacant, and continues down to unit B. Mrs Disher's house enjoys a view of the sea over the vacant unit C and over the roof of Mrs Farnworth's house on unit B. The view is interrupted to a limited extent by an upper storey room, described as a "lookout", which forms part of Mrs Farnworth's house.

The proceedings were brought by Mrs Disher. She claimed that the residence, which we shall refer to as Mrs Farnworth's, built on unit B exceeded the upper height limit for that unit as defined on the unit plan. It thereby intruded into the common property in contravention of the rules of the body corporate constituted by section 12 of the Act. Mrs Disher claimed that Mrs Farnworth and Mrs Godfrey built with full knowledge that the height limit would be exceeded, and that as a result she has suffered loss of view and loss due to the diminution in value of her property. She sought a mandatory injunction requiring the respondents to remove so much of the offending dwelling as is necessary to comply with the height limit. In the alternative, she claimed damages.

Mrs Godfrey filed no defence and took no part in the proceedings either in the High Court or in this Court. Mrs Farnworth filed a defence and counterclaimed for certain declarations, principally one increasing the upper height of unit B so as to include the whole of her residence as built.

The Judge found against Mrs Disher and entered judgment for Mrs Farnworth. On the counterclaim, he made a declaration adding to the rules of the body corporate a rule which recognised the respondents' right to retain or rebuild a structure which exceeded the height limit to the extent of the present structure, and prevented any person interested in any other unit from bringing any proceeding or taking any steps in derogation of that right. Mrs Disher appeals from the whole of the judgment.

## The Unit Titles Act 1972

The Unit titles Act 1972 enables the registered proprietor of a freehold or leasehold estate or of an estate under a Crown licence to subdivide the land into units. By section 3(1) such a subdivision will be into:

"(a) Two or more principal units; and

(aa) Such number of accessory units (if any) as the registered proprietor may wish; and

(b) Common property, being so much of the land as is not comprised in any unit."

The following definitions in section 2 are relevant:

"Accessory unit" means a unit that is designed for use with any principal unit (whether as a garden, garage, car parking space, storage space, swimming pool, laundry, stairway, passage, or other like purpose) and that is shown on a unit plan as an accessory unit:

"Body corporate", in relation to the units and common property shown on a unit plan and to the proprietor or proprietors of those units, means the body corporate that comprises the said proprietor or proprietors in accordance with section 12 of this Act

"Common Property" means common property within the meaning of paragraph (b) of subsection(]) of section 3 of this Act:

"Principal unit" means a unit that is designed for use (whether in conjunction with any accessory unit or not) as a place of residence or business or otherwise, and that is shown on a unit plan as a principal unit:

"Unit", in relation to any land, means a part of the land consisting of a space of any shape situated below, on, or above the surface of the land, or partly in one such situation and partly in another or others, all the dimensions of which are limited, and that is designed for separate ownership."

"Unit" is thus a space of which all the dimensions are limited. It is not, as is an ordinary Land Transfer Act title, defined only by reference to land surface boundaries. Its dimensions in the vertical plain must also be limited. The Act thus enables separate ownership of the different floors of a multi-storey building. Where, as in this case, the units are side by side and not superimposed one above the other, they must still satisfy the requirement that all dimensions must be limited.

By section 4, the subdivision is effected and stratum estates come into existence upon the deposit under the Land Transfer Act 1952 of a plan specifying the units in their relation to a building or buildings already erected on the land. The existing building in this case was that in the space which is now unit A, and which is occupied by Mrs Disher. Once created a stratum title can be dealt with as if it were an estate in the land. However, the original estate in the land cannot be dealt with, and the component parts of a stratum estate can in general be dealt with only as a whole: section 4(3). Upon the deposit of the unit plan the Registrar issues a certificate of title in the name of the registered proprietor for the stratum estate in all of the units and cancels any existing certificate of title: section 8. Separate certificates may be issued for individual units. The certificate is deemed to be a certificate of title for the purposes of the Land Transfer Act.

The proprietors of all the units on a unit plan are by section 12 constituted a body corporate with certain powers and duties. By section 37 the body corporate is regulated by certain rules set out in the Schedules to the Act which can be amended or added to, in most cases only by the unanimous resolution of the body corporate in general meeting. The rules provide that voting rights on a poll or on a special resolution are to correspond in value with the unit entitlements. By section 6, each principal and accessory unit is to be valued prior to the deposit of the unit plan in order to determine these "unit entitlements" on the basis of their relative values.

## The History of the Dispute

The property now comprised in the unit titles was formerly owned by the late Mr George Neville Stone-Wigg. The deceased had been a close friend of Mrs Disher's father since school days, and acted as a father to her and to her brother after their father died during World II. The deceased maintained close contact with Mrs Disher up to the time of his death. He also maintained a friendship with the respondents, whose father had been overseas with him during the War. In his will he made provision for both appellant and respondents in the following terms:

"5A I DIRECT my trustees to have the front part of the section (ocean side) of my property at 19 Ocean View Road Mt Maunganui surveyed, subdivided and registered as a new section and I FURTHER DIRECT that this new section should be the minimum area permissible to obtain a separate title PROVIDED THAT the existing house has access to the private road which now connects up with Te Ngaio Road and up the existing concrete ramp which leads up to the approximate level of the house and I GIVE DEVISE AND BEQUEATH this new section to PRUDENCE FARNWORTH and JANE GODFREY as tenants in common in equal shares SUBJECT TO a restrictive covenant to be registered on the title by my trustees that a two storied house shall not be built on this section except that a single story house with an eleven feet by eight feet look-out room may be built on the said section.

5B I GIVE DEVISE AND BEQUEATH my house property at No.19 Ocean View Road together with the remaining section to PAMELA JESSIE DISHER PROVIDED THAT this gift shall be subject to the said Pamela Jessie Disher raising and paying to my trustees the sum of $88,000 which amount I GIVE AND BEQUEATH equally between the following five persons ... "

The deceased died on 7 July 1986. The stipulation as to a restrictive covenant concerning building was, as the Judge held, intended to limit any derogation from the landscape or seascape views enjoyed by the house. It was not expressed in terms of a precise height limitation, but by requiring that a two-storeyed house should not be built, except for a lookout room of limited area.

The solicitors for the executrix learned that the operative District Scheme would not permit a subdivision of the property into separate freehold sections. A specified departure could have been applied for, but the solicitor for the trustee formed the view that it was inappropriate for the trustee to spend funds on a speculative application for the sole benefit of the respondents if there was another way in which the will could be carried out. The Judge accepted the propriety of that view, since the solution adopted, namely subdivision by way of unit title was capable of achieving the devise intended by the will. On 20 August 1986 the solicitors for the executrix wrote to Mrs Farnworth advising her of the situation and of their proposal for a unit title subdivision. They suggested she might wish to take independent advice and asked her to advise her wishes. She replied in due course advising that the unit title option was acceptable to her.

Prior to writing to Mrs Farnworth, the solicitors had instructed a surveyor to carry out the necessary survey work. Their letter set out the first portion of clause 5A of the will, including the reference to the new section being of the minimum area permissible to obtain a separate title, but did not include the reference to a restrictive covenant as to the number of storeys. The Judge found that this information was not conveyed in any other manner to the surveyor. The letter concluded:

"A family connection who is fully familiar with the property and knows deceased's wishes is Mrs P.J. Disher, No. 2 R.D., Otorohanga and we should be pleased if you would contact her and arrange to meet her on the property when you make your initial inspection."

The surveyor met Mrs Disher at the site and discussed the fixing of the upper height limit which was a necessary part of the definition of the proposed unit. Mrs Disher and her husband were naturally keen to preserve their views from the existing house, and wished to keep the height of any house on unit B as low as possible. Mrs Disher was aware of the restriction contained in the will, but there was a conflict as to whether she mentioned this to the surveyor. The Judge found that the surveyor went to the site having been advised that Mrs Disher knew all about the testator's wishes, found her evincing a clear and natural concern to preserve her views, and arrived at a unit height restriction which would allow the construction of a single storey house of minimum height. The Judge pointed out that such a constraint did not accord with the will, because there was no stipulation in the will that the single storey house and lookout should be the lowest possible height permissible by law.

The unit plan was deposited in April 1987 and unit titles were issued in August 1987 in the name of the executrix, one for units A and C and one for unit B. The solicitor for the executrix sent Mrs Farnworth a copy of the plan, which included a schedule setting out the respective areas, unit entitlements and upper and lower height limits for each of the units A, B and C, and for the accessory unit which provided units A and C with access to the right of way at the lower end of the site. The upper height limit for unit B was shown as 13.0 and the lower height limit as 7.5. These are metric distances from the Moturiki Datum. This is stated in the right hand panel of the unit plan as deposited, but was not shown in the photocopy of the plan sent to Mrs Farnworth. The photocopy of the plan does show an iron bar set in the ground in proximity to the subdivision at RL 11.50, which would enable the other levels to be interpreted. This might not be apparent to a lay person such as Mrs Farnworth, although her architect must have been well aware that the upper and lower height levels shown must be measured from some given point which could be readily ascertainable.

In October 1987 Mrs Farnworth instructed her architect. She gave him a photocopy of the first two pages of the will, which included the whole of clauses 5A and 5B. She gave him the photocopy of the unit plan which she had received from the estate solicitor. He said:

> "T I visited the site and established various levels from which it was apparent that the upper height limit of 13 metres relating to unit B was so restrictive that it would have been impossible to build a house, which included a lookout, without excavating the whole property down to the level of the formed right of way (a part of which can be seen at the end of the paling fence in Exhibit "C"). This would have involved a retaining wall of up to approximately eight feet around two sides of the house, with the consequence that there would be no sun on the western or northern sides of the house.
>
> 8. 1 think I probably discussed the matter with Mrs Farnworth. I certainly raised with her why she was not receiving a freehold subdivided section (as opposed to a unit title). My professional training meant that I had some knowledge of subdivisions, unit titles, and freehold titles. From my reading of the Will I was unable to understand why a unit title was to be provided, and not a separate title. Mrs Farnworth had not taken legal advice up to that time, and I thought she should do so before carrying the matter any further."

Mrs Farnworth duly sought legal advice, and was told that she was entitled to expect a freehold title. That issue was pursued with the solicitors for the estate, as was the possibility of applying for a specified departure. She was eventually advised that it would be necessary to take Court action unless she accepted a unit title. She preferred to accept the unit title so long as she could build a residence in terms of the will. Her solicitors recommended that she make sure that a residence could be built on unit B. She again consulted the architect, and instructed him to prepare basic plans. He again mentioned the height restriction, but she says he did not seem to be concerned about it, and she did not concern herself with such details. She said she regarded them as matters for the architect.

According to the architect's affidavit, he proceeded to draw preliminary plans for a dwelling "in accordance with the requirements under the will, but without complying with the upper height referred to in the unit title". This seems a somewhat extraordinary approach to adopt, but there is no doubt that it is what he did.

On 28 October 1987 Mrs Farnworth wrote to the estate's solicitors informing them that her legal advisers had told her that the will required a separate title and not a cross lease. In the course of their reply of 5 November pointing out that what was proposed was not a cross lease but a unit title, the solicitors said that the plan prepared by the surveyors was "a unit titles plan and is a subdivision complying with the provisions of the will". There were further exchanges of correspondence which concentrated on the adequacy of the area of the proposed unit B, and ended with Mrs Farnworth's letter of 31 January 1988 saying that she and her sister " will accept a transfer of unit B on plan 545042 in settlement of our entitlement under the will". Although the focus of the correspondence had been on area, Mrs Farnworth was by this date aware of a height restriction, but was possibly unaware that it was such as to create a problem. She seemingly did not appreciate that it would prevent her obtaining what the will provided. Her architect, however, was aware that the upper limit of the space comprising unit B would be exceeded by the proposed dwelling for which he was drawing preliminary plans, although his plans met the requirements under the will.

Mrs Disher confirmed with the surveyor that the upper height limit shown on the plan accorded with what he had shown her when he surveyed the property. She exercised her option under the will and completed her purchase of units A and C on 7 July 1988. These units had been separated into individual titles on 1 July 1988. Caveats lodged on that date by Mrs Farnworth prevented registration of the transfer to Mrs Disher.

On 23 April 1989 Mrs Disher and her husband became aware that construction had started on unit B. The unit titles were at this stage still in the name of the executrix. She went to the local council to inspect the building plans, and on 8 May 1989 her solicitors wrote to Mrs Farnworth pointing out that the plans showed a height of construction which clearly contravened the height limits contained in the unit plan. They said they were instructed to take all necessary steps to ensure that the height limitations were complied with, and suggested that construction work be stayed until appropriate rulings could be obtained. This led to a meeting at which there was a lengthy debate between the respective solicitors. Mrs Disher issued the present proceedings on 22 June 1989, initially to seek an interim injunction preventing further construction. On the same day there was registered a withdrawal by Mrs Farnworth of her caveats against the titles to units A, B and C and the transfers of unit B to the respondents and units A and C to Mrs Disher were registered that same day.

## The Judgement in the High Court

The Judge found that Mrs Disher had had a copy of the will, and had the means of knowing that the will contemplated a building restriction. When she received the unit plan she knew that it provided a height restriction. She must have known that this was to her advantage, and to the disadvantage of Mrs Farnworth. Because they both took as beneficiaries under the same will, the Judge concluded that Mrs Disher owed a fiduciary duty to Mrs Farnworth to at least take reasonable steps to ensure that the latter was fully informed of the implications of a perceived greater restriction under the unit title arrangement than the testator intended by his will. Her response was to leave it to the estate's solicitor, as being nothing to do with her. Such a response, the Judge held, was inconsistent with her fiduciary duty.

The Judge then turned to consider whether in fact the unit height prevented Mrs Farnworth from building above that height, and whether Mrs Disher had any right of action in respect of her doing so. He accepted the validity of a submission made on behalf of Mrs Farnworth that the area above the height limit was not "common property", because it was not shown as such on the unit plan, this being contemplated by section 5(l)(g) of the Act. He referred also to section 5(2) and to section 5A(l). If the air space above the height restriction on unit A was not common property, then it followed in the Judge's view that Mrs Disher could not sue for an intrusion into it, and could not obtain a remedy for the mere obstruction of her view. If he was wrong in this, then the breach of the fiduciary duty which he had found earlier would, in his view, amount to an equitable barrier to the granting of relief to Mrs Disher.

The Judge went on to record what he would have awarded if he had concluded that it was a proper case for awarding damages to Mrs Disher. A valuer had given evidence of a diminution in value of $15,000 in respect of unit A and $10,000 in respect of unit B by reason of the obstruction of the view. The maximum height allowed for unit C was identical with that for unit B, so that if unit B could not lawfully exceed 13m above the Moturiki Datum, nor could unit C. Since Mrs Disher's case assumed that there was no right of user of air space above the maximum vertical height, unit C had lost nothing to which it was not otherwise lawfully vulnerable. No allowance for loss could, in his view, be made sensibly in respect of unit C. In respect of unit A, he was of the view that a pleasant seascape was now partially replaced with a closer artificial construction which might be regarded by at least some potential purchasers as "aesthetically unbecoming". He accepted the valuer's figure of $15,000 as being appropriate, and would have awarded this amount if damages had been recoverable.

He then referred to Mrs Farnworth's counterclaim. He said that ideally one would wish to clarify the position of the parties by way of orders which would lead to an amendment to the existing unit plan by increasing the vertical height from 13m to say 15.75m, but he could find no provision in the Act under which this could be done. It could not be done under section 44 dealing with redevelopments, because in his view the air space above unit B was not common property and the definition of "redevelopment" in section 2 allowed the enlargement of a unit only by the inclusion in it of an adjoining portion either of common property or of another unit shown on the plan. The only way he could find to grant Mrs Farnworth the relief to which he held she was entitled was to declare that the rules of the body corporate should be added to by the inclusion of a new rule recognising her right to maintain or rebuild a structure which intruded into the space above the registered vertical height to the extent of the present structure.

## The First Two Grounds of Appeal

The first ground of appeal raised by Mr Page was that Mrs Farnworth's dwelling did not comply with the restrictions contained in the will. The will required a restrictive covenant that a two storeyed house should not be built on the section, except that a single storey house with a lookout room of the stipulated size might be built. No restrictive covenant was registered, as apparently the District Land Registrar took the view that such a covenant could not be registered against a unit title. Mr Page submitted, however, that Mrs Farnworth's dwelling comprised two storeys without talking into account the lookout room.

Reference to the architect's plan shows that something like half of the house is at ground level, the other half being supported on pillars which he said provided the usual 2.4m stud height. This provided a basement parking area, and in addition an entrance foyer and stairway leading to the floor above. He submitted that it was clearly possible without any structural alteration to enclose the basement area to create a room or rooms half the size of the lfoor above.

The Judge rejected the proposition that the minuscule entrance foyer with stairs leading to the first floor amounted to a storey as to render the dwelling fairly capable of the description of "a two storey house". We agree with the Judge that this would be to strain beyond recognition the natural meaning of the term in common usage. Likewise, we do not think that the ability to enclose the basement so as to create further living space is sufficient to make the building in its present form other than a single storeyed building, if one disregards the lookout. If the basement were enclosed and additional rooms created, then the house might well be described as of more than one storey, effectively one and a half storeys. It cannot fairly come within that description while the basement is merely an open car parking space. To enclose the basement would infringe the building restriction contained in the will. If it had been possible to create a separate freehold title and to register a building restriction in terms of the will, despite its imprecision, then the subsequent enclosure of the basement would infringe that restriction. Because unit B is a unit title, any future enclosure of the basement would be covered by rule 1(f) of the rules of the body corporate, which provide:

> "(1) A proprietor shall -
>
> (f) make no additions or structural alterations to the unit without the consent of the body corporate."

The second ground of appeal attacked the Judge's finding that the air space above the upper height limit of unit B was not common property, so that the use of it by Mrs Farnworth did not infringe any rights of Mrs Disher. There is no doubt that the right to use the air space over the whole of the land was one of the incidents of ownership attaching to the registered proprietor of the original certificate of title. The original certificate of title has been replaced by the unit titles as a consequence of the subdivision, which in terms of section 3 is a subdivision into principal units, accessory units and common property. The latter is defined in section 3 as "being so much of the land as is not comprised in any unit". Prima facie, all the rights of the original owner falling outside the limited dimensions of the principal and accessory units shown on the unit plan must be common property owned in common by all the owners of units, but under the control of the body corporate in accordance with its rules. Section 9 provides that the common property is to be held by the proprietors of all the units as tenants in common in shares proportional to the unit entitlement in respect of their respective units. By section 4(2) this share in the common property is comprised within the stratum estate which is created in each unit by the deposit of the plan.

The Judge reached a different conclusion based primarily on section 5(l)(g) of the Act. This provides:

"5(1) A unit plan may not be deposited

(g) Unless a certificate in the form set out in the Fourth Schedule to this Act has been given in writing by the principal administrative officer of the territorial authority in whose district the land is situated to the effect that every building shown on the plan has been erected, and all other development work has been carried out, to the extent necessary to enable all the boundaries of every unit and the common property shown on the plan to be physically measured."

This paragraph does not require the unit plan to expressly state or define every part of the common property. It merely requires that the plan be certified to the effect that all building and development work has been carried out to the extent necessary to enable the boundaries of the common property shown on the plan to be physically measured. If, for example, in the case of a multi-storey building there are areas shown on the plan which are to be held as common property, then the plan must enable them to be identified and measured. In this case the air space is common property because it is not comprised within any principal or accessory unit. It is bounded by the vertical extension of the side boundaries of unit B and comprises the whole of the air space above the upper height limit shown on the unit plan. It extends upwards in the same way that the original freehold title included rights to air space. It does not have any measurable upper boundary, and requires no further definition. It is not shown on the plan and so does not come within section 5(l)(g).

The Judge referred to section 5(2), which refers to "all the units in common property shown on the plan", and to section 5(A)(1) which also refers to "common property shown on the plan", but neither of these subsections requires that all common property is to be shown on the plan. They apply only to common property which is shown on the plan, and in such case any work necessary to enable it to be physically measured must have been completed.

We conclude, therefore, that the air space above units A, B and C and not comprised within those units must in terms of section 3 (b) of the Act be common property. That being so, it is held in common by the proprietors of all the units in shares proportional to their unit entitlement in respect of their respective units. The intrusion into such air space by one unit holder without the consent of the body corporate is an infringement of the rights of the other unit holders.

## Fiduciary Obligation

The Judge based his finding of breach of fiduciary duty on the proximity of the parties as beneficiaries under the same will, Mrs Disher being aware or having the means to be aware that the unit plan provided a height restriction in place of the building restriction in the will with a consequent advantage to her and a corresponding disadvantage to the defendant. With all respect to the Judge, we do not think a fiduciary obligation can be created on such a slender foundation. A constructive trust is not to be imposed on the basis of some vague idea of what might seem fair. As was said by Somers J in *Elders Pastoral Ltd v Bank of New Zealand* [1989] 2 NZLR 180 at 193, it is used to prevent a person from retaining a benefit in breach of his legal or equitable obligations. Mrs Disher had no such obligations to Mrs Farnworth. The same means of knowledge was available to Mrs Farnworth, who likewise had a copy of the will and had a copy of the unit plan showing that there were upper and lower height limits. There is nothing to suggest that she relied in any way on Mrs Disher, or was misled by Mrs Fisher. Fiduciary obligations are not lightly to be imposed, and the mere fact of "proximity" is not sufficient to create them.

Mr Chisholm, for Mrs Farnworth, referred to the fact that she had been asked to agree only with the unit title concept and we accept that this was so in the initial stages. Her agreement to the concept did not indicate any commitment to the detail of the unit plan. We can accept that when she received a copy of the unit plan, which omitted. the reference to the Moturiki Datum, the meaning and effect of the upper and lower limits scheduled on the face of the plan would not have been obvious to her. She relied, as would most people in such a situation, on the advice of her solicitor and architect. If they did not draw her attention to the fact that she was obtaining less than she was entitled to obtain under the will, then she is not entitled to blame Mrs Disher for this.

Mr Chisholm referred to the fact that Mrs Disher had played some part in the setting of the upper limit to unit C in that the estate's solicitor had told the surveyor to consult with her, and she had indicated to him her concern for her view and the heights at which the view would be impeded. There is nothing to suggest that in so doing she was doing any more than conveying her own wishes to the surveyor so that they would be taken into account. She was not purporting to direct him on behalf of the executrix as to his task. In one portion of her cross-examination she said "I was acting on instructions from Mr Mazengarb", but in its context this means no more than that Mr Mazengarb had told the surveyor to consult with her, and therefore she was not acting improperly in talking to him and expressing her own concerns. Mr Mazengarb had not delegated to her the task of interpreting the will to the surveyor.

Somewhat unaccountably the estate solicitor had not quoted the building restriction portion of the clause of the will when he wrote to instruct the surveyor, and the surveyor was unaware that Mrs Farnworth was to have the right to go beyond a single storey building to the extent of the lookout room mentioned in the will. There is no evidence that Mrs Disher was aware of the solicitor's failure to inform the surveyor in this regard.

There was certainly a fiduciary obligation owed by the executrix to all the beneficiaries to ensure that they obtained what they were entitled to receive under the will, or as near as was practical given that subdivision could only be effected under the Unit titles Act. The executrix relied on her solicitor, and it seems clear that the unit title created was not in conformity with the will. It would have achieved the intention of the will if it had provided a greater upper height limit. The problem became known to Mrs Farnworth's architect in October 1987, and must have become known to Mrs Farnworth soon thereafter, before she wrote accepting "a transfer of unit B on plan 545042 in settlement of our entitlement under the will". She agreed that she knew of the height restriction on 3 August 1988 when she again consulted the architect and instructed him to prepare basic plans. At that stage the executrix was still the registered proprietor of each of the unit titles. If the matter had been raised at that stage, it could have been rectified. Instead, Mrs Farnworth's architect proceeded to draw the preliminary plans for the dwelling in accordance with the provisions of the will, but knowing that they did not comply with the upper height referred to in the unit title. Mrs Disher had no part to play in this, and cannot in any way be blamed for it.

It might be fair to say that neither should Mrs Farnworth be blamed for it. She was entitled to rely on her professional advisers, and the evidence produced in this case does not disclose that she realised the implications of her problem or the consequences of proceeding with a building which exceeded the height dimension on the unit plan. In these proceedings, however, we are only concerned with her rights if any against the other unit owner.

### Indefeasibility of Mrs Disher's Title

Even at the stage when Mrs Disher first noticed that building had commenced and herself inspected the building plans at the Council's office, and then drew the attention of Mrs Farnworth to the fact that the building would breach the height restriction, it would not have been too late for the problem to have been solved. 'Be executrix was still the registered proprietor of the titles and was in a position to do what the will required her to do, namely to allow Mrs Farnworth and her sister to build a single storey dwelling with the lookout room above it. Mrs Farnworth was protected by the caveat she had lodged against the unit titles. For reasons which do not appear from the papers, she withdrew the caveats and allowed the units to be transferred out of the common ownership of the executrix into the separate ownership of Mrs Disher as to units A and C and Mrs Farnworth and her sister as to unit B. Once those transfers were registered, Mrs Disher obtained an indefeasible title under the Land Transfer Act to units A and C. By virtue of section 4 (2) of the Unit Titles Act, that indefeasible title included the undivided share in the common property to which she was entitled as a tenant in common under section 9.

At the stage when Mrs Farnworth withdrew her caveat and allowed these registered interests to be created, her advisers should have been well aware that she would be acting at her peril. They could have asked the executrix to use the "redevelopment" provisions of section 44 of the Act, and to apply as registered proprietor of all the units to deposit a new unit plan in substitution for the existing plan. In this way the problem could have been solved. Mrs Disher's equitable rights as unregistered purchaser of units A and C arose subsequent to Mrs Farnworth's rights until the will, and could not have had priority. Instead, for reasons not explained to us, the caveats were withdrawn and the transfer to Mrs Disher allowed to be registered.

Mr Chisholm sought to meet the difficulty arising from the registration of the transfers by reference to the High Court judgment in *Secureland Mortgage Investments Nominees Ltd v Herman & Co Solicitor Nominee Co Ltd* (1991] 2 NZLR 399. In that case Williams J at 410-411 referred to the principle that indefeasibility cannot be relied upon as a defence to a claim in personam. He went on, however, to say that the two accepted situations were where there is priority of contract between the parties, or where the registered proprietor has undertaken a trust or has entered into a fiduciary relationship. In the latter case, he emphasised that principles of constructive or equitable notice cannot be applied in order to defeat the indefeasibility principle, and the obligations to be enforced must have been entered into by the registered proprietor. In the present case there is no contract between the parties, and Mrs Disher has not entered into a fiduciary relationship. It follows that Mrs Disher has acquired an indefeasible title.

### Remedy

The upstairs lookout room and most of the first storey roof of Mrs Farnworth's house intrudes into the air space above unit B. That air space is by section 9 of the Unit Titles Act 1972 common property held as tenants in common by the parties as owners of all the units. The erection on one's own land of a structure which invades the air space of another is actionable as a trespass: *Kelsen v Imperial Tobacco Co (of Great Britain and Ireland) Ltd* [1957] 2 QB 334. It would seem also to be a breach of rule 1(f) of the rules of the body corporate, as being an addition or structural alteration to the "unit" without the consent of the body corporate. The body corporate has power under section 13(2) to sue for damage or injury to the common property, but that section does not take away the right of an individual owner as tenant in common to sue for trespass, or for breach of the rules under section 37(11). Section 14 appears to affect only actions against the body corporate. In this Court the respondent sensibly did not press the argument that the body corporate should have been the plaintiff, and it is unnecessary to consider it further.

The amended statement of claim asked for an injunction ordering the removal of the offending portion of the dwelling on unit B, or in the alternative damages. To order removal would be a draconian remedy, disproportionate to any harm suffered by Mrs Disher from the loss of some of her view. Also relevant is the fact that although Mrs Disher is entitled to succeed because of the maximum height on the unit title and her indefeasible title under the Land Transfer Act, she is in that favourable position only because of the mistakes and misunderstandings of others. If the intentions of the will had been properly implemented, Mrs Farnworth's house and Mrs Disher's view would be exactly as they now are, and Mrs Disher would have had no ground for complaint. This is clearly not a case for the issue of a mandatory injunction, but is one where damages are a more appropriate remedy. We turn then to the question of damages. The Judge said he would have awarded $15,000 in respect of the diminution in value of Mrs Disher's house on unit A, in accordance with the evidence of the valuer, Mr Fisher. The evidence correctly measured the loss to unit A, not the loss to all the owners of the common property in the air space. The figure was not challenged in this Court, and should be accepted.

Mr Fisher also assessed at $10,000 a loss of value to unit C. The Judge disallowed this. Unit C has a maximum height of only 13 metres above the datum, the same as unit B. Any house built on unit C would necessarily have its view taken from it by a dwelling erected on unit B, even if the latter dwelling was confined to the permitted height. The valuer does not appear to have taken account of this fact. He has also included in his assessment the effect of Mrs Farnworth's house being only 1 metre from the boundary. Because the Borough Scheme requires dwellings to be 6 metres apart, this causes a loss of buildable area to unit C. However, this is irrelevant to the present claim, which refers only to the excessive height. There was no other evidence which would have enabled any damages to have been awarded for loss of value to unit C, and the Judge was correct to reject this part of the claim.

### Counterclaim

The Judge made a declaration on the respondent's counterclaim purporting to add to the rules of the body corporate.

There is no jurisdiction under the Unit Titles Act for the Court to amend the rules by declaration. That can only be done by unanimous resolution of the proprietors under section 37(2), or in the case of the rules in the Third Schedule, by the body corporate in general meeting under section 37 (3). No doubt if there had been a breach of fiduciary obligation, as the Judge found, the Court in its equitable jurisdiction might have required the respondent to join in passing an appropriate resolution, but that question does not now arise.

## Conclusion

We accordingly allow the appeal, and enter judgment in favour of Mrs Disher as appellant for damages in the sum of $15,000. These damages are awarded in lieu of an injunction, and compensate for the past and future loss of view and diminution of value.

It is to be hoped that at this stage the parties will address the situation in order to achieve a long term solution. The present problems do not appear to have been due to the personal fault of either of them. This has been an expensive exercise for Mrs Farnworth, who may or may not have remedies against other parties. She and Mrs Disher are neighbours and share property in common. Both have something to gain from sensible cooperation. Unless there is a redevelopment and a new unit plan amending the maximum heights, or a transfer of part of the common property under section 9(3), Mrs Farnworth can maintain her existing house only so long as it lasts. If it is burnt down she can only rebuild to reduced level 13.0. Mrs Disher's unit C is presently limited to the same maximum height, so that any building on unit C must be significantly lower than Mrs Farnworth's present house. It would seem desirable to raise the upper height limit of both units B and C.

The appellant is entitled to costs in this Court and in the High Court, for which we allow a global figure of $5,000, together with disbursements and witnesses expenses in the High Court as fixed by the Registrar of that Court, and together with disbursements in this Court including the cost of printing and the reasonable travel and accommodation costs of counsel as fixed by the Registrar of this Court.

## Solicitors

Edmonds Judd, Te Awamutu, for Appellant

Willis Toomey Robinson, Napier, for Respondent

*Valuation of city block for District Valuation Roll - Objection to valuation of $11.8 million - Retail shops on the property leased - Whether value of freehold estate was to be reduced by value of burden of leases estimated at $2.7 million - Valuation of Land Act 1951, ss 8, 11, 15, 41, 45, 46.*

In The High Court Of New Zealand (Administrative Division)
Wellington Registry AP No. 172/89

Under the Valuation of Land Act 1951

In The Matter of a determination of the Land Valuation Tribunal at: Wellington

Between The Valuer-General Appellant

And Radford And Company Limited Respondent

Hearing: 4 February 1993

Counsel: C B Littlewood for Appellant

F Miller and Jennifere Cassie for Respondent

Judgment: 17 May 1993

## Judgment Of Greig J

The respondent is the owner of the fee simple of a small city block between Manners and Victoria Streets in Wellington City which is generally known as the Shoreline Retail Complex. In the revision of the District Valuation Roll as at I May 1987 the Capital Value and the Land Value of the property was shown at $11.8 million. The value of Improvements was therefore nil. In spite of the fact that there is a relatively new complex of retail shops on the property it was common ground that the property needed to be valued as a redevelopment site. The respondent objected to the valuation. One of the issues was whether the value as a redevelopment site was $11.8 million or $11 million. The Wellington Land Valuation Tribunal resolved that in favour of the appellant and there is no further issue taken in that respect.

The second issue, which is the principal issue in this appeal, is whether as contended by the respondent, the value should be reduced by an amount calculated as the burden of the leases which it was estimated was an amount equal to $2.7 million. The Land Valuation Tribunal found in favour of the respondent, determining the value of its estate or interest in the land less the burden of the leases as $9.1 million. The Valuer-General appeals against that decision and, as well, contends that the basis upon which the respondent's valuer estimated the burden of the lease is in error.

The respondent acquired the land in two lots in the late 1930's and for many years conducted a retail furniture business from old buildings on the site. In or about 1982 it determined to redevelop the area and to promote it for modern retail shopping. This was to some extent a new departure and a new form of pioneering because that part of the city had become run down and was not considered as part of the central business retail area. Some nine retail shops and a small coffee lounge were constructed.

In order to attract tenants and to obtain occupation of the premises relatively generous terms of lease were provided.

The leases, which all commenced during 1983, were for terms of ten years with a right of renewal for a further period of ten years. Base rent was payable reviewable at two-yearly intervals and the lessees were required to meet a proportion of the operating expenses of the respondent including rates, insurance and other outgoings but not including Land Tax which remained payable by the respondent lessor. There was no provision in the leases which would permit the lessor to terminate the lease if it wished to demolish existing buildings and redevelop the site. It may be observed that the leases are of the internal space of the buildings, that is, from the upper side of the floor slab to the lower side of the ceiling and the internal side of the walls.

In the years which followed there was very substantial redevelopment in the Manners Street vicinity, such that, although the property was only recently developed, by 1987 the only sensible option was to redevelop the whole property. That could only be done by obtaining vacant possession from the lessees. By early 1987 some efforts had been made to obtain vacant possession and a sum of $200,000 each was offered to them. Four declined that offer and demanded greater sums between $350,000 and $730,000. In the end no development took place.

It was common ground that the property should be valued as a development site which meant on a vacant land basis without regard to any value of improvements. The Valuer-General contends that in practice, principle and proper construction of the statutory provisions the amount of the Land Value and the Capital Value of this property should take no account of the existence of the lessees' interests.

The argument, based on practice, was founded on the evidence of the Assistant Valuer-General that to his knowledge the department, preparing valuation rolls, has never taken into account the existence of leases when valuing the owner's freehold interest. The determination of lessees' interests and their value was only taken into account for certain purposes of Land Tax and at the instigation of the Commissioner of Inland Revenue. The problems or difficulties of the result of the tribunals decision was said to be the multiplicity of entries that would be required, thus in this particular case the District Valuer would be obliged to create new entries in the roll for the respondents interests and also for the interests of the nine lessees, making ten entries in all. In larger high rise buildings there could be many more separate entries to be created. I observe that the witness for the Valuer-General, the Assistant Valuer-General, accepted that the practice and understanding of the department was subject, of course, to the determination and decision of the proper authority, the tribunal or the court.

The argument on principle was based on the understanding necessity of the creation and the continuation of a stable, consistent and equitable basis among all owners for the assessment of rates by local authorities. Although the Valuation of Land Act, its officers and their duties and functions are separate and independent from local authorities and their rating under the Rating Powers Act 1988 or its predecessor the Rating Act 1967, the latter depends upon the valuation rolls which are the basis for preparing the local authority rolls for rating purposes. Moreover the expressions "Land Value", "Capital Value" and "Annual Value" upon which rates are assessed, paid and levied, are all identical to those in the Valuation of Land Act. It is the entries of these values in the valuation rolls which are the bases of the actual rates. Thus it is the occupier of any rateable property who is primarily liable for rates under the rating statutes and that is the same person as is defined as occupier under the Valuation of Land Act. So it is contended that the focus of rating being upon occupiers, adjacent properties in the same neighbourhood of same or similar nature should pay the same rates or at least on a uniform basis. The liability of persons such as the owner or a lessee or any person with another interest in the property is entirely secondary. Furthermore, the rates payable by owners should not depend upon the particular contractual arrangements they may have made with lessees as this would tend to disrupt the consistency of a rating system and make rates depend upon or become affected by factors pertaining to a particular property rather than factors which affect properties generally in a particular district or neighbourhood of similar size and circumstances.

While both these arguments as to practice and principle can be accepted and given weight, they cannot override the true meaning of the statute. The argument as to principle, in any event, assumes the fundamental importance of the occupier of the property but if it is a question of interest in the property then the consistency must be between those with the same interest. In any event it may be questioned whether the stability or consistency of valuation and rate assessment requires that properties be treated as if they were all in the one form of ownership. It may be rather that the burden of rates should be spread equally among all properties proportionate to the value of them. That object can be achieved though there may be more than one person taking a proportion of the burden in respect of any one property. Thus two neighbouring properties will pay the same rates, or a proportionate equitable share of these, though one in single ownership and occupation will be met by one person only and another with multiple occupation or interests may have the amount paid by more than one.

Turning then to the construction of the statute. It is appropriate to start with the Valuer-General's obligation under s II of the Act on a revision to make "all such alterations as are necessary in order that the capital and land values and value of improvements ... may be readjusted and corrected so as to represent the correct values as at the time of revision." Because the question of improvements does not enter into the matter, it is the land value which is the crucial item. That is defined in the Act as follows:

> `Land value', in relation to any land, means the sum which the owner's estate or interest therein, if unencumbered by any mortgage or other charge thereon, might be expected to realise at the time of valuation if offered for sale on such reasonable terms and conditions as a bona fide seller might be expected to impose, and if no improvements (as hereinbefore defined) had been made on the said land: "

It is appropriate to add here the definitions of improvements, land and owner.

> "'Improvements', in relation to any land, means all work done or material used at any time on or for the benefit of the land by the expenditure of capital or labour by any owner or occupier thereof in so far as the effect of the work done or material used is to increase the value of the land and the benefit thereof is unexhausted at the time of valuation; but, except in the case of land owned or occupied by the Crown or by a statutory public body, does not include work done or material used on or for the benefit of the land by the Crown or by any statutory public body, except so far as the same has been paid for by way of direct contribution:
>
> Provided that work done or material used on or for the benefit of the land by the expenditure of capital or labour by any owner or occupier thereof in the provision of roads or streets, or in the provision of water, drainage, or other amenities in connection with the subdivision of the land for building purposes shall not be deemed to be improvements on that land or any other land:
>
> Provided also that work done on or for the benefit of the land by any owner or occupier thereof in -
>
> (a) The draining, excavation, filling, or reclamation of the land, or the making of retaining walls or other works appurtenant to that draining, excavation, filling, or reclamation; or
>
> (b) The grading or levelling of the land or the removal of rocks, stone, sand, or soil therefrom; or
>
> (c) The removal or destruction of vegetation, or the effecting of any change in the nature or character of the vegetation; or
>
> (d) the alteration of soil fertility or of the structure of the soil; or
>
> (e) The arresting or elimination of erosion or flooding-
>
> shall not be deemed to be improvements on that land or on any other land: "
>
> "'Land' means all land, tenements, and hereditaments, whether corporeal or incorporeal, in New Zealand, and all chattel or other interests therein, and all trees growing or standing thereon:

That includes leasehold interests.

Owner is defined:

"'Owner' means the person who, whether jointly or separately, is seised or possessed of or entitled to any estate or interest in land. "

The Valuer-General's primary obligation under s 8 is to -

"... set forth in respect of each separate property the following particulars:

(a) The name of the owner of the land, and the nature of his estate or interest therein, together with the name of the beneficial owner in the case of land held in trust:

(b) The name of the occupier ...

(c) The situation, description, and area of the land:

(d) The nature and value of the improvements:

(e) The land value of the land:

(f) The capital value of the land:

(ff) Where applicable, the special rateable value or the rates postponement value of the land:

(g) Such other particulars as are prescribed. "

In estimating the land value without improvements the valuer has to assume that there is nothing on the property in the way of improvements: see *Toohey's Ltd v Valuer-General* [1925] AC 439 at 443. He is required to assume the buildings which have already been erected be regarded as removed: see *McKee v Valuer-General* [1971] NZLR 436 at 446. That, however, does not mean that a lessee's right of occupation is to be ignored. There may be no buildings and so no shops or shop tenants but the right of a lessee are still extant with the notional removal of the building. It does not make a difference, in my judgment, that the premises leased to the lessee are the internal surface of the building and not any part of the land, on its surface, below it, or in the air above the building. There is a lease of the land or that part of the land in the air space in the inside of the building. It is not, I think, to be assumed on the notional removal of the buildings that they have been destroyed by fire or earthquake under the terms of a lease which terminate it in those circumstances. The exclusion of mortgages and other encumbrances, mortgage or other charge, does not include a lease. It is not possible to add to that exclusion the lease or the interest in it.

Mr Littlewood argued that the reference to separate property in s 8 which is, in itself, an undefined term, meant that that comprised all of the bundle of rights relevant to a specific and legally defined area of land. That, he submitted, reinforced the practical and principled approach of the Valuer-General, maintaining a single roll entry for each separate property as a whole. He submitted therefore that the reference to the land in subpara (a) of s 8 (1) meant separate property, thus it was the name of the owner of the separate property and the nature of his estate or interest therein which was required to be valued. That focussed on the "property occupied and used as one holding", in the words used by Ostler J in *Walters v Supreme Court. Register* [1936] NZLR 546 at 550, and meant that only one value of any separate property could be assessed. That it was not appropriate, his word, to assess one value for an owner and another different value for a lessee. *Walters* case raised an issue of geographic separation. The property was intersected by two roads but was in one ownership occupation and used as a farm. Clearly persons can leave different interests in a separate property and the "particulars" required in s 8 include "the nature of his estate or interest therein" and the "name of the beneficial owner" in land held in trust. The section contemplates in respect of any separate property a division of interest or estate and consequently a value or values for those interests and estates in "the land" as distinct from the separate property.

The question in the end, however, is the estimate of the realisable value of the owner's estate or interest at the relevant time. What was the respondent's estate or interest? It was fee simple, a freehold estate or interest in the whole of the land in that separate property. Without improvements and unencumbered by any mortgage or other charge it remains affected, from the point of view of realisation, by the leases. A bona fide seller offering for sale his freehold estate subject to these leases will realise or expect to realise a sum, which takes into account the benefit or detriment of those leases. In my judgment, therefore, on a plain reading of the relevant definitions and section the valuer must take into account the effect of the leases so far as they have any effect on the expected realisable sum. That seems to be consistent with the assumption that the land, though notionally vacant and without buildings, is not restored to its primitive or primeval state but is subject to all the existing chances which may affect its value at the date of valuation. Thus, as in *McKee's* case, the chance which the owner of the land may have of obtaining a consent to a particular use and likewise the opportunity to sell as a development site are all matters to be taken into account. A lease, though a private contractual arrangement and not an environmental factor applying unilaterally and without any contribution by the owner, is still a present feature or factor which needs to be taken into account.

There is elsewhere in the Act reference to leases. For example s 15 which permits the Valuer-General to make alterations or adjustments of value in leased land which may be necessary for the purposes of "correctly assessing the respective interests of the respective owners at any specified time". Further, s 41, which provides for new valuations on request of any land or of any estate or interest in land, provides in subs (7) that, where there are more interests in the land than one and a valuation is required of any interest in the land the value of that interest when added to valuation made at the same date of the remaining interests, will be equal to the value of the land "as if it were held by a single owner in fee simple and free from any lease or encumbrance". A similar phrase is used in subs (8) limiting the right of objection to new valuations made under s 41. Section 46 also makes reference to leases and any onerous conditions on the lessee. The Valuer-General in his discretion may make allowance to the lessee in respect of the detrimental effect on the lessee "'in assessing the capital value of the lessee's and lessor's interest in the leased land".

Not only therefore do these sections recognise the possibility of separate assessments in respect of leasehold interests but they indicate a recognition of the likelihood of the fee simple interest, the lessor's interest, being affected and so requiring adjustment as set out in these subsections.

Mr Littlewood emphasised the particular purposes of ss 15 and 41 and linked them to the provisions of s 45, repealed in 1970, when that was part of the Act. That does not, however, dispose of the underlying effect of those sections or the fact that, in spite of the repeal of s 45, the sections have remained in force. They must serve some purpose apart from s 45. It is curious, too, to note that s 46 refers still to s 45 as the last preceding section although it no longer exits.

Something more needs to be said about s 45. This involves a discussion of two authorities which are apparently in conflict but which bear upon the question of issue in this case. The first of these was relied upon by the tribunal in coming to its decision. That case is *Findlay v Valuer-General* [1954] NZLR 76, a decision of the Land Valuation Court delivered by Archer J whose long experience gives to his judgments particular authority.

This arose out of an appeal by the owner of a house property which was divided into two flats. He objected to the valuation placed upon the property upon a revision of the District Valuation Roll. It was common ground that the flats were tenanted; that if offered for sale on a "`vacant possession" basis, the property might reasonably be expected to realize the amount fixed by the Land Valuation Committee as its capital value (£2,725); and that, if offered for sale subject to existing tenancies, it would not realize that amount. It was contended by the owner, as objector before the Committee and as appellant before the Court, that she was entitled to have the property valued for Roll revision purposes on the basis of the price it might be expected to realize if sold as a tenanted property. The question before the Court was limited to that issue. The judgment of the Court, delivered by Archer J, after stating the primary purpose of the Act was to establish district valuation rolls as a basis for rating and thus to provide an equitable basis for the assessment of rates, went on to state four propositions, at p 79, as follows:

" 1. That the owner of any estate or interest in land is entitled to have that estate or interest valued and entered upon the district valuation roll.

"2. That, in valuing that estate or interest, any mortgage or other charge thereon is to be disregarded.

"3. That, where in respect of any land there are more interests and more owners than one, the united capital values of the interests of all the owners must not be less than the capital value of the land if held in fee simple by a single owner free from encumbrances.

We think that a further and consequential proposition based upon these propositions may be enunciated:

4. That no deduction may be made from the capital value of land by reason of a charge thereon which does not constitute an estate or interest in land, or which, though it may constitute an interest in land, has no value or cannot be valued.

He noted that the Valuer-General had disregarded the tenancies following his usual practice, stating:

" ... and one which he claims to be both in accordance with the Valuation of Land Act, 1951, and logically desirable in the preparation of a roll to be used for rating purposes. "

That mirrors the submissions made before me in this appeal which underlines the long period during which this practice has been followed. It was conceded in the case by the appellant that, although there was no evidence as to what rights the tenancies created, the tenants were not possessed of interest in land. It was held, therefore, that the provisions of s 45 did not apply because it was not a case in which there were more interests in the land or more owners than one.

The judgment then proceeds, at p 81: What has to be valued, according to s 8, is the estate or interest of the owner in the land. The definition of capital value makes it clear that the owner's estate or interest is to be valued as if unencumbered by any mortgage or other charge thereon. Section 45 provides that where there are leasehold or other interests, and, therefore, more owners than one, the aggregate of the capital values assessed shall not be less than the capital value of the land `if held by a single owner in fee simple free from any lease or encumbrance.' These words indicate, in our opinion, that an owner of land must be assessed with the full value of the unencumbered fee simple unless he can show that he has divested himself of a leasehold or other interest which is capable of separate valuation.

To approach the matter from a slightly different angle, we are of opinion that the primary function of the Valuer-General under the Valuation of Land Act 1951, is to value estates or interests in land, disregarding mortgages and charges or encumbrances which do not constitute interests in land. By this means, the Legislature has sought to ensure that every property bears its fair share of liability for rates. Its intention, as set out in the Act, is that, where an owner in fee simple has divested himself of a lesser estate or interest in land, the value of the land, and the consequent liability for rates, may be apportioned between the owners of the various interests in the land in accordance with the values of their respective interests. "

He summed up the matter in this way:

To sum up, we are of opinion that an objection by the owner of a property which is apparently held in fee simple and which has been correctly valued as such upon the revision of a district valuation roll can succeed only if the objector can show that he has divested himself of an interest in the land, the value of which can be separately assessed.

It is, I think appropriate to quote s 45 as it was before its repeal in 1970. It was as follows:

45.(1) Where land is subject to a lease or in any other case where there are more interests therein and more owners than one, the united capital values, values of improvements, and unimproved values respectively of the interests of all the owners shall not be estimated at less than the capital value, value of improvements, and unimproved value of the land would be estimated at if held by a single owner in fee simple and free from any lease or encumbrance, anything to the contrary in this Act notwithstanding.

(2) For the purposes of this section -

(a) The interest of a lessor is the present value of the net rent under the lease for the unexpired term, plus the present value of the reversion to which he is entitled:

(b) The interest of a lessee is the present value of the excess (if any) of five per cent per annum upon the capital value of the leased land over and above the aforesaid net rent for the unexpired term, plus the present value of any right to compensation or of purchase or other valuable consideration to which he is entitled under the lease, and minus the interest (if any) of a sublessee:

(c) The interest of a sublessee shall be computed in the same manner, with the necessary modifications, as that of a lessee, and so on in like manner for any interest inferior to that of a sublessee:

(d) All apportionments of the interests of lessors, lessees, and sublessees in respect of improvements and of land exclusive of improvements shall be made in the proportion that the capital value of the ]eased land bears to the value of the improvements thereon and to the unimproved value thereof respectively, subject *pro tanto* to any provisions of the lease whereby the lessee or sublessee has a special interest in the improvements or in the land exclusive of improvements, as the case may be:

(e) All computations of present values shall be made on a five per cent per annum compound interest basis:

(f) `Lease' includes agreement to lease, licence, and any other written document for the tenancy or occupancy of land; `rent' includes premium, fine, royalty, and any other consideration for the tenancy or occupancy of land. "

In 1968 there came before the Land Valuation Court another appeal. It was then presided over by Tompkins J who gave the decision of the Court reported in *Valuer-General v Addington Raceway Ltd* [1969] NZLR 327. This was an appeal against the unimproved value fixed on a periodical revision as at 1 November 1965. The land was owned in fee simple by the North Canterbury Hospital Board and was leased to Addington Raceway Ltd for ten years, renewable until 26 November 2047. There was some 80 years still to run. The judgment sets out a number of principles applicable in fixing the unimproved value, the second of which was as follows:

" 2. The unimproved value must be calculated as if held by a single owner and free from any lease or encumbrance: s 45 *(supra).* "

The application of s 45 and its meaning and effect as regards the lease was clearly an issue in the case. It was argued for the Raceway that the section did not forbid taking the lease into account but that was rejected, the Judge saying, at p 330:

"Section 45 says categorically that, in fixing the unimproved value, the lease must be disregarded. "

That was repeated at p 331 in these words:

"We are concerned here only with unimproved value and s 45 provides that the unimproved value shall be estimated as if held by a single owner, in fee simple, free from any lease. In our view the section forbids taking the lease into account, even when considering the chance of a change of zoning. "

I note that, although a number of cases are recorded as being cited and referred to, no reference is made to *Findlay's* case.

The last quotation above contains a reference to the final words in subs (1) of the former s 45. They are intended to govern the global or whole value of all the interests. It refers clearly and specifically to any lease. But in order to find the global interest, the whole value, then it is necessary to ignore leases and all other encumbrances, not just mortgages and charges, because otherwise the total freehold value would not be ascertained and thus the separate interests, when added together, would not come to the total figure. For that limited purpose, then, leases must be ignored. But with respect I think Tompkins J went too far if what he said was intended to mean that leases are to be disregarded in fixing the unimproved value of the land.

What is, I think, clear enough is that before 1970, when it was repealed, s 45 raised by implication the necessity of considering the separate interests and so having regard to the interests of the lease and its effect on the value in estimating the owner's interest. Its repeal, however, does not reverse the position, nor does it make the pronouncements in *Findlay's* case no longer applicable. With respect, I think Archer J was correct in his view on the matter and I believe that the repeal of s 45 does not change that. The Act in all other respects remains the same and there [are] still the sections which I have referred to which, at least implicitly, acknowledge and recognise the need to take into account the leasehold interest. In my judgment the tribunal was correct in its conclusion at p 15, that "the value of the objector's estate or interest in the Shoreline site was the marketable value of the fee simple estate less the marketable value of the nine leases", or as affected by the existence of those leases.

It was the appellant's further contention that, as he put it, there was an incorrect methodology in the presentation of the expert evidence which was so unsatisfactory that it ought not to have been relied upon in respect of the valuations he gave to the lessee's interest in the property in question.

What the valuer did, in this case, was to estimate the cost of acquiring the vacant possession or the lessees' interest. He had a number of comparative examples and concluded his opinion that the value of each tenant's interest in the property was in the order of $300,000 each. In coming to that conclusion he noted, firstly, that there was no fixed formula for the assessment of the value of leasehold interest including, in some cases, a benefit in the rent where the current rent payable was less than might have to be met in alternative premises; secondly, that there are costs to the tenants in setting up new premises; and, thirdly, the amount to be paid by a developer as an inducement to obtain the surrender of the tenants' rights of occupation. There was no challenge, at least in the sense of any contrary evidence, nor does there appear to have been any challenge in cross-examination of the valuer as to that methodology. I think the tribunal was in error in saying, as it did, that Mr Littlewood had accepted the value of the leases as estimated by the valuer, although there was a concession that a base could have a separate value.

As I have said, what was required to be done was to value the owner's interest, that is to say the freehold interest affected, as it was, by the existence of the leases. It was not a question of valuing the leases but valuing the fee simple and the effect of the leases on that having regard to the redevelopment purpose. In those circumstances the principle adopted that it was, in effect, the cost of obtaining surrender and freeing the land for redevelopment must be appropriate and in the absence of any other evidence the tribunal was entitled, and indeed bound, to accept the evidence before it. That was well justified and had some confirmation from the evidence of Mr Radford, on behalf of the owner, and his discussions and attempts to obtain by purchase the surrenders of the leases. In the result, then, the amount so allowed at $2.7 million cannot be challenged.

The decision made by the tribunal was that the District Valuation Roll, as revised, should show separate entries in respect of the objector's estate or interest in property as well as the interest of each of the lessees, the total to equal $11.8 million. They then went on to determine the value of the objector's estate or interest as $9.1 million. The latter was all that was in issue in the case before the tribunal. It may be that the inevitable result of that is the necessity for separate entries being made in the District Valuation Roll but that is not, as I understand it, an order or direction made by the tribunal.

In the result the appeal is dismissed. No question of costs was rated in this matter and so no order is made.

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# NEW ZEALAND INSTITUTE OF VALUERS

## MISSION STATEMENT

The New Zealand Institute of Valuers encourages its membership to develop high standards of professionalism and excellence through the provision of education, support services and promotion.

The New Zealand Institute of Valuers membership comprises professionally qualified persons who value, appraise, advise, consult, manage, arbitrate and negotiate in all respects of land, buildings and other real and personal assets.

## STATEMENT OF OBJECTIVES

To achieve this the Institute will continue to

1. Provide a framework within which members may advance their educational and professional development within a diverse membership activity.
2. Provide a progressive organisation responsive to change and membership needs.
3. Provide channels of communication between members, the organisation and the public.
4. Encourage maximum member participation in the affairs of the Institute.
5. Develop, set and effectively maintain standards of practice for the benefit of both the membership and public while ensuring fair and expeditious disciplinary procedures are available.
6. Establish education, admission and categories of membership criteria and provide appropriate pathways to admission.
7. Encourage research and develop viable services of benefit to members.
8. Develop closer association and cooperation with other professional bodies both in New Zealand and overseas.

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ISSN 0113-0315